



2016  
ANNUAL REPORT

You've come to the right place.®



Dear Fellow Shareholders:

Thanks to the collective, enthusiastic and determined efforts of our entire team, and strong support from you, our shareholders, 2016 was another successful year for Highwoods. We improved the quality of our portfolio with \$892 million of total capital recycling and investment activity, significantly de-levered our balance sheet and returned capital to our shareholders, all while delivering solid net income and FFO per share growth. This volume of work will benefit our Company in the years to come.

## 2016 – A Year In Review

In 2016, we achieved a 23.2% total shareholder return, delivered a solid 6.5% growth in FFO per share, reduced year-over-year leverage by 1000 basis points, lowered debt-to-EBITDA by 1.3 turns and declared an \$0.80 per share special dividend – the first in our Company’s history. We achieved a robust 5.2% same property cash NOI growth, bolstered by maintaining a portfolio-wide average occupancy of 92.8%, pushing rents, keeping a lid on operating expenses and delivering best-in-class customer service. We also made material strides to further improve our portfolio by:



- delivering \$122 million of development, including Laser Spine Institute in Tampa, Seven Springs West in Nashville and Enterprise V in Greensboro;
- announcing \$70 million of new development, including 5000 CentreGreen in Raleigh and Virginia Urology in Richmond;
- acquiring \$117 million of BBD-located assets, including Charter Square in Raleigh and land parcels in Nashville, Pittsburgh and Raleigh; and
- selling \$705 million of assets, including our retail-centric Country Club Plaza assets in Kansas City.

Bottom line, we delivered strong operating and investment metrics atop the best balance sheet Highwoods has ever had. We ended the year with leverage of 34.7% (based on gross book assets and including preferred stock), a debt-to-EBITDA ratio of 4.78x, nothing drawn on our \$475 million credit

facility and \$49 million of cash on hand. And, based on our strengthening cash flows, which will be further enhanced as our highly pre-leased \$645 million development pipeline delivers, we increased our quarterly cash dividend to \$0.44 per share on February 7th of 2017. This equates to an annualized dividend of \$1.76 per share, a 3.5% increase.

## Strategic Plan – Our Vision For Delivering Long-Term Value To Our Shareholders

The core tenets of our Strategic Plan launched in 2005... people, portfolio, communications and balance sheet ... continue to drive our Company. Our ability to execute and sustain these principles has resulted in meaningful total returns for shareholders. Over the past 12 years, our compounded annual return to shareholders has averaged 10.8%. While certain years have yielded higher returns than others, we have improved the Company each year. With that in mind, below I share additional details about our people, portfolio, growth drivers, capital recycling strategy and balance sheet as well as our outlook for 2017.

First, let's start with our people. We firmly believe our people give us a competitive edge. In my opinion, our property management, maintenance and customer service teams are second to none, and their professionalism has driven high customer satisfaction and strong retention. The coordination between our in-house leasing and property management teams often enables us to identify needed improvements or adjustments before the condition becomes a problem for our customers. Also, our corporate marketing department has done a superior job with their creativity and heavily-involved efforts in our leasing activities and build-to-suit proposals. As I've said before, back when we launched our Strategic Plan in 2005, attracting, retaining and empowering great people is, and always will be, critical to our success. The senior leadership team and I know our consistent and solid performance relies on the talented individuals throughout our Company.

We manage our business the way that we operate our Company - with close coordination and collaboration among all divisions and all departments. Our decision making methodology is not autocratic, top-down. Rather, our senior leadership team takes a consensus-building approach. We are a group with varied specialties and backgrounds, and we learn well from each other. We believe our approach to strategic decisions and problem-solving leverages valuable perspectives across our Company and enables us to make more informed and better decisions. Akin to a parent balancing a child's independence vs. a child's safety (i.e. at what age do you let your kid go to the concert without parental supervision....and be the driver?), we routinely pit risk and entrepreneurialism vs. conservatism. We are certainly not perfect. But, we study and measure the outcomes of past decisions and come to work each day determined to make our Company better than the day before.



Buckhead, Atlanta

Next is our portfolio and market strategy. The demographic trends across our footprint are attractive. Our markets:

- have population growth roughly double the national average;
- experience high-performing job growth, driven by the business-friendly environment in our right-to-work states; and
- enjoy a highly desirable quality of life, with below average cost of living.

We are often asked whether we prefer urban or suburban properties in our markets. We believe there are benefits to each, but it differs by submarket. We focus our portfolio in the BBDs (best business districts) in each of our markets. BBDs can be urban submarkets, such as the central business districts (CBDs) of Pittsburgh, Raleigh, Orlando and Tampa and the vibrant Buckhead submarket of Atlanta. They can also be suburban submarkets such as Innsbrook in Richmond, the airport in Greensboro, Cool Springs in Nashville, the Poplar Corridor in Memphis and Weston in Raleigh. The common theme among BBD submarkets is they each have a mosaic of unique aspects that makes it a compelling place where businesses want to be and grow. Or, said another way, BBDs are usually the last submarkets to de-lease in bad times and the first to re-lease in improving times. We've disposed of a lot of assets in non-BBD locations since the launching of our Strategic Plan and heavily focus our attention on developing and acquiring assets in BBDs. Today, almost 90% of the portfolio is concentrated in BBDs.

As I start my 35th year with Highwoods, I can easily say that I've never been associated with a piece of real estate as unique as Country Club Plaza in Kansas City. However, we believe the decision to sell these assets when we did was right for our Company. During our history of ownership, we grew NOI at Country Club Plaza to its all-time high, and cap rates for retail properties were at or near all-time lows. In addition to monetizing our Country Club Plaza assets at an office/retail-blended 4.7% cash cap rate, exiting Kansas City enabled us to further enhance our BBD office focus, lower our leverage, simplify our business model and garner G&A savings. It was a difficult decision, but we don't believe any single asset in our portfolio is sacred.

We deployed approximately \$460 million of the \$660 million of proceeds from the Plaza sales into BBD-located office properties and land at prices that offer attractive investment returns, significant future upside and landmark real estate positions. Staying true to our goal of being disciplined allocators of capital, we did not use the remainder to acquire any additional buildings, predominantly because we found pricing to be out of sync with our view of the risk/reward profile of the opportunities available during the narrow 1031 tax gain-deferral window. Instead, we used those proceeds to bolster our future dry powder by further reducing our leverage and declared the first special dividend in our Company's history.



We acquired three BBD-located land parcels in 2016. Two went towards replenishing our development land inventory and the other was fee simple title under EQT Plaza in Pittsburgh, which was previously on a ground lease. Land isn't a large portion of our overall asset base at just around \$110 million, or about 1.5% of our enterprise value, but it has been and always will be an important driver of our development pipeline. As we monetize land for new development projects, we expect to continue to replenish our core land inventory. One of the development parcels we acquired in 2016 is the last sizable development site in the Maryland Farms submarket in the Nashville area. It will support over 200,000 square feet of office space in a submarket that has less than 5% vacancy. The other development site we acquired is in downtown Raleigh, directly adjacent to our PNC Plaza and can accommodate a 300,000+ square foot office tower.



The single building acquisition we closed in 2016 was Charter Square in downtown Raleigh. This property is a strategic complement to our existing downtown Raleigh portfolio and further strengthens our position as the dominant landlord in that submarket. We continue to look for additional properties that enhance our existing operations, but given the stout pricing for high-quality assets, finding meaningful acquisitions has become increasingly challenging.

We delivered \$122 million of development in 2016. As I write this, we now have a healthy development pipeline of \$645 million that will deliver and is projected to stabilize over the next three years. Our development pipeline has been a strong FFO driver and cash flow strengthener over the past 12 years, and we are actively pursuing additional development projects. We have a core land bank of 224 acres that can support over \$1 billion of additional development. We pay careful attention to the amount of risk our development pipeline has, but given our high preleasing rate (currently over 80% on a dollar-weighted basis), open book cost structure on many projects and solid credit across our preleased customers, we believe we have been very prudent investing our shareholders' capital.

Property fundamentals across our portfolio remain healthy. In addition to the overall attractiveness of our markets, there has been a limited supply of new office properties during this cycle. At the end of 2016, there was only 1.1% of existing office stock under construction across our nine markets -- this is well below the prior peak of 3.2% and under the 1.3% average since 2006. If demand keeps pace, then we don't anticipate increased risk of softer fundamentals across our markets.

We've never had a stronger balance sheet than what we now have and, candidly, we are very proud of it. Given our current debt metrics, we're often asked about our leverage comfort zone going forward. The sweet spot for us is to continue to operate in the range of 35-40% in terms of leverage and 4.5 to 5.5 turns in terms of debt-to-EBITDA. Together with having 92.6% of our NOI unencumbered, we have significant flexibility to fund our development pipeline and capitalize on growth opportunities while maintaining a sound and steady risk profile.



## 2017 – Our Outlook

While cognizant of the challenges that lie ahead, we enter 2017 upbeat about the health of our business and the building blocks for sustained growth that we've put in-place over the past several years. A few items should drive increased earnings and continue strengthening our cash flows. Our \$645 million development pipeline is 81% preleased on a dollar weighted basis and will provide NOI as the 11 projects stabilize. We expect \$303 million of development stabilizations in 2017, \$67 million in 2018 and \$252 million in 2019. In 2017, our \$200 million, 100% pre-leased Bridgestone Americas headquarters tower in Nashville will deliver in September. We also just replaced a \$380 million bond maturity with a \$300 million, 10-year bond with a stated coupon of 3.875% -- about 200 basis points below the expiring rate. We have a \$200 million

bond maturity in 2018 that has a 7.5% coupon rate and we're hopeful about garnering another meaningful interest rate reduction. We acquired \$511 million of value add properties over the last 18 months that were, on average, 77% occupied with known move-outs -- we remain upbeat about stabilizing these properties and growing our NOI.

Our challenges include replenishing our well pre-leased development pipeline, identifying properly priced, institutional-quality acquisition opportunities and, of course, leasing vacant space while capturing renewals.

We continue a strict adherence to our Strategic Plan. We stay vigilant to being good stewards of our shareholders' capital through focused and driven efforts to continuously:

- improve the quality of our portfolio;
- maintain and further bolster a strong balance sheet;
- be transparent and candid with our shareholders; and
- empower and challenge our team of highly-seasoned real estate professionals to always look ahead for new challenges and new opportunities.

This is our plan once again in 2017.

On behalf of all of us at Highwoods, I am sincerely appreciative of the support we've earned from you. Thank you!

Respectfully,



Edward J. Fritsch  
President and Chief Executive Officer

March 31, 2017

# HIGHWOODS PROPERTIES, INC.

## TABLE OF CONTENTS

<b>Item No.</b>		<b>Page</b>
<b>PART I</b>		
1.	BUSINESS	3
1A.	RISK FACTORS	4
1B.	UNRESOLVED STAFF COMMENTS	13
2.	PROPERTIES	14
3.	LEGAL PROCEEDINGS	17
X.	EXECUTIVE OFFICERS OF THE REGISTRANT	18
<b>PART II</b>		
5.	MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	19
6.	SELECTED FINANCIAL DATA	22
7.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	23
7A.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	41
8.	FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	41
9.	CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	41
9A.	CONTROLS AND PROCEDURES	42
9B.	OTHER INFORMATION	44
<b>PART III</b>		
10.	DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE	45
11.	EXECUTIVE COMPENSATION	45
12.	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	45
13.	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE	45
14.	PRINCIPAL ACCOUNTANT FEES AND SERVICES	45
	INDEX TO CONSOLIDATED FINANCIAL STATEMENTS	46

## EXPLANATORY NOTE

We refer to Highwoods Properties, Inc. as the “Company,” Highwoods Realty Limited Partnership as the “Operating Partnership,” the Company’s common stock as “Common Stock” or “Common Shares,” the Company’s preferred stock as “Preferred Stock” or “Preferred Shares,” the Operating Partnership’s common partnership interests as “Common Units” and the Operating Partnership’s preferred partnership interests as “Preferred Units.” References to “we” and “our” mean the Company and the Operating Partnership, collectively, unless the context indicates otherwise.

The Company conducts its activities through the Operating Partnership and is its sole general partner. The partnership agreement provides that the Operating Partnership will assume and pay when due, or reimburse the Company for payment of, all costs and expenses relating to the ownership and operations of, or for the benefit of, the Operating Partnership. The partnership agreement further provides that all expenses of the Company are deemed to be incurred for the benefit of the Operating Partnership.

Certain information contained herein is presented as of January 27, 2017, the latest practicable date for financial information prior to the filing of this Annual Report.



## PART I

### ITEM 1. BUSINESS

#### General

Highwoods Properties, Inc., headquartered in Raleigh, is a publicly-traded real estate investment trust ("REIT"). The Company is a fully integrated office REIT that owns, develops, acquires, leases and manages properties primarily in the best business districts (BBDs) of Atlanta, Greensboro, Memphis, Nashville, Orlando, Pittsburgh, Raleigh, Richmond and Tampa. Our Common Stock is traded on the New York Stock Exchange ("NYSE") under the symbol "HIW."

At December 31, 2016, the Company owned all of the Preferred Units and 101.3 million, or 97.3%, of the Common Units. Limited partners owned the remaining 2.8 million Common Units. Generally, the Operating Partnership is obligated to redeem each Common Unit at the request of the holder thereof for cash equal to the value of one share of Common Stock based on the average of the market price for the 10 trading days immediately preceding the notice date of such redemption, provided that the Company, at its option, may elect to acquire any such Common Units presented for redemption for cash or one share of Common Stock. The Common Units owned by the Company are not redeemable.

The Company was incorporated in Maryland in 1994. The Operating Partnership was formed in North Carolina in 1994. Our executive offices are located at 3100 Smoketree Court, Suite 600, Raleigh, NC 27604, and our telephone number is (919) 872-4924.

Our primary business is the operation, acquisition and development of office properties, which accounted for more than 97% of our annualized cash rental revenues as of December 31, 2016. There are no material inter-segment transactions. See Note 19 to our Consolidated Financial Statements for a summary of the rental and other revenues, net operating income and assets for each reportable segment.

Our website is [www.highwoods.com](http://www.highwoods.com). In addition to this Annual Report, all quarterly and current reports, proxy statements, interactive data and other information are made available, without charge, on our website as soon as reasonably practicable after they are filed or furnished with the Securities and Exchange Commission ("SEC"). The information on our website does not constitute part of this Annual Report. Reports filed or furnished with the SEC may also be viewed at [www.sec.gov](http://www.sec.gov) or obtained at the SEC's public reference facilities. Please call the SEC at (800) 732-0330 for further information about the public reference facilities.

During 2016, the Company filed unqualified Section 303A certifications with the NYSE. The Company and the Operating Partnership have also filed the CEO and CFO certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002.

#### Business and Operating Strategy

Our Strategic Plan focuses on:

- owning high-quality, differentiated office buildings in the BBDs of our core markets;
- improving the operating results of our properties through concentrated leasing, asset management, cost control and customer service efforts;
- developing and acquiring office buildings in BBDs that improve the overall quality of our portfolio and generate attractive returns over the long term for our stockholders;
- disposing of properties no longer considered to be core assets primarily due to location, age, quality and/or overall strategic fit; and
- maintaining a conservative and flexible balance sheet with ample liquidity to meet our funding needs and growth prospects.

**Local Market Leadership.** We focus our real estate activities in markets where we have extensive local knowledge and own a significant amount of assets. In each of our core markets, we maintain offices that are led by division officers with significant real estate experience. Our real estate professionals are seasoned and cycle-tested. Our senior leadership team has significant experience and maintains important relationships with market participants in each of our core markets.

**Customer Service-Oriented Organization.** We provide a complete line of real estate services to our customers. We believe that our in-house leasing and asset management, development, acquisition and construction management services generally allow us to respond to the many demands of our existing and potential customer base. We provide our customers with cost-effective services such as build-to-suit construction and space modification, including tenant improvements and expansions. In addition, the breadth of our capabilities and resources provides us with market information not generally available. We believe that operating efficiencies achieved through our fully integrated organization and the strength of our balance sheet also provide a competitive advantage in retaining existing customers and attracting new customers as well as setting our lease rates and pricing other services. In addition, our relationships with our customers may lead to development projects when these customers seek new space.

**Geographic Diversification.** Our core portfolio consists primarily of office properties in Raleigh, Atlanta, Tampa, Nashville, Memphis, Pittsburgh, Richmond and Orlando and office and industrial properties in Greensboro. We do not believe that our operations are significantly dependent upon any particular geographic market.

**Conservative and Flexible Balance Sheet.** We are committed to maintaining a conservative and flexible balance sheet that allows us to capitalize on favorable development and acquisition opportunities as they arise. Our balance sheet also allows us to proactively assure our existing and prospective customers that we are able to fund tenant improvements and maintain our properties in good condition.

### Competition

Our properties compete for customers with similar properties located in our markets primarily on the basis of location, rent, services provided and the design, quality and condition of the facilities. We also compete with other domestic and foreign REITs, financial institutions, pension funds, partnerships, individual investors and others when attempting to acquire, develop and operate properties.

### Employees

At December 31, 2016, we had 438 full-time employees.

## ITEM 1A. RISK FACTORS

An investment in our securities involves various risks. Investors should carefully consider the following risk factors in conjunction with the other information contained in this Annual Report before trading in our securities. If any of these risks actually occur, our business, results of operations, prospects and financial condition could be adversely affected.

**Adverse economic conditions in our markets that negatively impact the demand for office space, such as high unemployment, may result in lower occupancy and rental rates for our portfolio, which would adversely affect our results of operations.** Our operating results depend heavily on successfully leasing and operating the office space in our portfolio. Economic growth and employment levels in our core markets are and will continue to be important factors in predicting our future operating results.

Key components affecting our rental and other revenues include average occupancy, rental rates, cost recovery income, new developments placed in service, acquisitions and dispositions. Average occupancy generally increases during times of improving economic growth, as our ability to lease space outpaces vacancies that occur upon the expirations of existing leases. Average occupancy generally declines during times of slower economic growth and decreasing office employment because new vacancies tend to outpace our ability to lease space. In addition, the timing of changes in occupancy levels tends to lag the timing of changes in overall economic activity and employment levels. For additional information regarding our average occupancy and rental rate trends over the past five years, see “Item 2. Properties.” Lower rental revenues that result from lower average occupancy or lower rental rates with respect to our same property portfolio will adversely affect our results of operations unless offset by the impact of any newly acquired or developed properties or lower variable operating expenses, general and administrative expenses and/or interest expense.

**We face considerable competition in the leasing market and may be unable to renew existing leases or re-let space on terms similar to the existing leases, or we may spend significant capital in our efforts to renew and re-let space, which may adversely affect our results of operations.** In addition to seeking to increase our average occupancy by leasing current vacant space, we also concentrate our leasing efforts on renewing existing leases. Because we compete with a number of other developers, owners and operators of office and office-oriented, mixed-use properties, we may be unable to renew leases with our existing customers and, if our current customers do not renew their leases, we may be unable to re-let the space to new customers. To the

extent that we are able to renew existing leases or re-let such space to new customers, heightened competition resulting from adverse market conditions may require us to utilize rent concessions and tenant improvements to a greater extent than we anticipate or have historically. Further, changes in space utilization by our customers due to technology, economic conditions and business culture also affect the occupancy of our properties. As a result, customers may seek to downsize by leasing less space from us upon any renewal.

If our competitors offer space at rental rates below current market rates or below the rental rates we currently charge our customers, we may lose existing and potential customers, and we may be pressured to reduce our rental rates below those we currently charge in order to retain customers upon expiration of their existing leases. Even if our customers renew their leases or we are able to re-let the space, the terms and other costs of renewal or re-letting, including the cost of required renovations, increased tenant improvement allowances, leasing commissions, reduced rental rates and other potential concessions, may be less favorable than the terms of our current leases and could require significant capital expenditures. From time to time, we may also agree to modify the terms of existing leases to incentivize customers to renew their leases. If we are unable to renew leases or re-let space in a reasonable time, or if our rental rates decline or our tenant improvement costs, leasing commissions or other costs increase, our financial condition and results of operations would be adversely affected.

**Difficulties or delays in renewing leases with large customers or re-leasing space vacated by large customers could materially impact our results of operations.** Our 20 largest customers account for a significant portion of our revenues. See “Item 2. Properties - Customers” and “Item 2. Properties - Lease Expirations.” There are no assurances that these customers, or any of our other large customers, will renew all or any of their space upon expiration of their current leases.

**Some of our leases provide customers with the right to terminate their leases early, which could have an adverse effect on our financial condition and results of operations.** Certain of our leases permit our customers to terminate their leases as to all or a portion of the leased premises prior to their stated lease expiration dates under certain circumstances, such as providing notice by a certain date and, in many cases, paying a termination fee. To the extent that our customers exercise early termination rights, our results of operations will be adversely affected, and we can provide no assurances that we will be able to generate an equivalent amount of net effective rent by leasing the vacated space to others.

**Our results of operations and financial condition could be adversely affected by financial difficulties experienced by a major customer, or by a number of smaller customers, including bankruptcies, insolvencies or general downturns in business.** Our operations depend on the financial stability of our customers. A default by a significant customer on its lease payments would cause us to lose the revenue associated with such lease. In the event of a customer default or bankruptcy, we may experience delays in enforcing our rights as landlord and may incur substantial costs re-leasing the property. We cannot evict a customer solely because of its bankruptcy. On the other hand, a court might authorize the customer to reject and terminate its lease. In such case, our claim against the bankrupt customer for unpaid, future rent would be subject to a statutory cap that might be substantially less than the remaining rent actually owed under the lease. As a result, our claim for unpaid rent would likely not be paid in full and we may be required to write off deferred leasing costs and accrued straight-line rents receivable. These events could adversely impact our financial condition and results of operations.

**An oversupply of space in our markets often cause rental rates and occupancies to decline, making it more difficult for us to lease space at attractive rental rates, if at all.** Undeveloped land in many of the markets in which we operate is generally more readily available and less expensive than in higher barrier-to-entry markets such as New York and San Francisco. As a result, even during times of positive economic growth, we and/or our competitors could construct new buildings that would compete with our existing properties. Any such oversupply could result in lower occupancy and rental rates in our portfolio, which would have a negative impact on our results of operations.

**In order to maintain and/or increase the quality of our properties and successfully compete against other properties, we regularly must spend money to maintain, repair, renovate and improve our properties, which could negatively impact our financial condition and results of operations.** If our properties are not as attractive to customers due to physical condition as properties owned by our competitors, we could lose customers or suffer lower rental rates. As a result, we may from time to time make significant capital expenditures to maintain or enhance the competitiveness of our properties. There can be no assurances that any such expenditures would result in higher occupancy or higher rental rates or deter existing customers from relocating to properties owned by our competitors.

**Costs of complying with governmental laws and regulations may adversely affect our results of operations.** All real property and the operations conducted on real property are subject to federal, state and local laws and regulations relating to environmental protection and human health and safety. Some of these laws and regulations may impose joint and several liability on customers, owners or operators for the costs to investigate or remediate contaminated properties, regardless of fault or whether

the acts causing the contamination were legal. In addition, the presence of hazardous substances, or the failure to properly remediate these substances, may hinder our ability to sell, rent or pledge such property as collateral for future borrowings.

Compliance with new laws or regulations or stricter interpretation of existing laws may require us to incur significant expenditures. Future laws or regulations may impose significant environmental liability. Additionally, our customers' operations, operations in the vicinity of our properties, such as the presence of underground storage tanks, or activities of unrelated third parties may affect our properties. In addition, there are various local, state and federal fire, health, life-safety and similar regulations with which we may be required to comply and that may subject us to liability in the form of fines or damages for noncompliance. Any expenditures, fines or damages we must pay would adversely affect our results of operations. Proposed legislation to address climate change could increase utility and other costs of operating our properties.

Discovery of previously undetected environmentally hazardous conditions may adversely affect our financial condition and results of operations. Under various federal, state and local environmental laws and regulations, a current or previous property owner or operator may be liable for the cost to remove or remediate hazardous or toxic substances on such property. These costs could be significant. Such laws often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. Environmental laws also may impose restrictions on the manner in which property may be used or businesses may be operated, and these restrictions may require significant expenditures or prevent us from entering into leases with prospective customers that may be impacted by such laws. Environmental laws provide for sanctions for noncompliance and may be enforced by governmental agencies or private parties. Certain environmental laws and common law principles could be used to impose liability for release of and exposure to hazardous substances, including asbestos-containing materials. Third parties may seek recovery from real property owners or operators for personal injury or property damage associated with exposure to released hazardous substances. The cost of defending against claims of liability, of complying with environmental regulatory requirements, of remediating any contaminated property, or of paying personal injury claims could adversely affect our financial condition and results of operations.

**Our same property results of operations would suffer if costs of operating our properties, such as real estate taxes, utilities, insurance, maintenance and other costs, rise faster than our ability to increase rental revenues and/or cost recovery income.** While we receive additional rent from our customers that is based on recovering a portion of operating expenses, increased operating expenses will negatively impact our results of operations. Our revenues, including cost recovery income, are subject to longer-term leases and may not be quickly increased sufficient to recover an increase in operating costs and expenses. Furthermore, the costs associated with owning and operating a property are not necessarily reduced when circumstances such as market factors and competition cause a reduction in rental revenues from the property. Increases in same property operating expenses would adversely affect our results of operations unless offset by higher rental rates, higher cost recovery income, the impact of any newly acquired or developed properties, lower general and administrative expenses and/or lower interest expense.

**Recent and future acquisitions and development properties may fail to perform in accordance with our expectations and may require renovation and development costs exceeding our estimates.** In the normal course of business, we typically evaluate potential acquisitions, enter into non-binding letters of intent, and may, at any time, enter into contracts to acquire additional properties. Acquired properties may fail to perform in accordance with our expectations due to lease-up risk, renovation cost risks and other factors. In addition, the renovation and improvement costs we incur in bringing an acquired property up to our standards may exceed our original estimates. We may not have the financial resources to make suitable acquisitions or renovations on favorable terms or at all.

Further, we face significant competition for attractive investment opportunities from an indeterminate number of other real estate investors, including investors with significantly greater capital resources and access to capital than we have, such as domestic and foreign corporations and financial institutions, publicly-traded and privately-held REITs, private institutional investment funds, investment banking firms, life insurance companies and pension funds. Moreover, owners of office properties may be reluctant to sell, resulting in fewer acquisition opportunities. As a result of such increased competition and limited opportunities, we may be unable to acquire additional properties or the purchase price of such properties may be significantly elevated, which would reduce our expected return from making any such acquisitions.

In addition to acquisitions, we periodically consider developing or re-developing properties. Risks associated with development and re-development activities include:

- the unavailability of favorable financing;
- construction costs exceeding original estimates;
- construction and lease-up delays resulting in increased debt service expense and construction costs; and

- lower than anticipated occupancy rates and rents causing a property to be unprofitable or less profitable than originally estimated.

Development and re-development activities are also subject to risks relating to our ability to obtain, or delays in obtaining, any necessary zoning, land-use, building, occupancy and other required governmental and utility company authorizations.

**Illiquidity of real estate investments and the tax effect of dispositions could significantly impede our ability to sell assets or respond to favorable or adverse changes in the performance of our properties.** Because real estate investments are relatively illiquid, our ability to promptly sell one or more properties in our portfolio in response to changing economic, financial and investment conditions is limited. We intend to continue to sell some of our properties in the future as part of our investment strategy and activities. However, we cannot predict whether we will be able to sell any property for the price or on the terms set by us, or whether the price or other terms offered by a prospective purchaser would be acceptable to us. We also cannot predict the length of time needed to find a willing purchaser and close the sale of a property.

Certain of our properties have low tax bases relative to their estimated current market values, and accordingly, the sale of such assets would generate significant taxable gains unless we sold such properties in a tax-deferred exchange under Section 1031 of the Internal Revenue Code or another tax-free or tax-deferred transaction. For an exchange to qualify for tax-deferred treatment under Section 1031, the net proceeds from the sale of a property must be held by an escrow agent until applied toward the purchase of real estate qualifying for gain deferral. Given the competition for properties meeting our investment criteria, there could be a delay in reinvesting such proceeds or we may be unable to reinvest such proceeds at all. Any delay or limitation in using the reinvestment proceeds to acquire additional income producing assets could adversely affect our near-term results of operations. Additionally, in connection with tax-deferred 1031 transactions, our restricted cash balances may be commingled with other funds being held by any such escrow agent, which subjects our balance to the credit risk of the institution. If we sell properties outright in taxable transactions, we may elect to distribute some or all of the taxable gain to our stockholders under the requirements of the Internal Revenue Code for REITs, which in turn could negatively affect our future results of operations and may increase our leverage.

**Because holders of Common Units, including one of our directors, may suffer adverse tax consequences upon the sale of some of our properties, they may seek to influence us not to sell certain properties even if such a sale would otherwise be in our best interest.** Holders of Common Units may suffer adverse tax consequences upon the sale of certain properties. Therefore, holders of Common Units, including one of our directors, may have different objectives than our stockholders regarding the appropriate pricing and timing of a property's sale. Although the Company is the sole general partner of the Operating Partnership and has the exclusive authority to sell any of our properties, those who hold Common Units may seek to influence us not to sell certain properties even if such sale might be financially advantageous to us or influence us to enter into tax deferred exchanges with the proceeds of such sales when such a reinvestment might not otherwise be in our best interest.

**Our use of joint ventures may limit our flexibility with jointly owned investments.** In appropriate circumstances, we own, develop and acquire properties in joint ventures with other persons or entities when circumstances warrant the use of these structures. Types of joint venture investments include noncontrolling ownership interests in entities such as partnerships and limited liability companies and tenant-in-common interests in which we own less than 100% of the undivided interests in a real estate asset. Our participation in joint ventures is subject to the risks that:

- we could become engaged in a dispute with any of our joint venture partners that might affect our ability to develop or operate a property;
- our joint ventures are subject to debt and the refinancing of such debt may require equity capital calls;
- our joint venture partners may default on their obligations necessitating that we fulfill their obligation ourselves;
- our joint venture partners may have different objectives than we have regarding the appropriate timing and terms of any renovation, sale or refinancing of properties;
- our joint venture partners may be structured differently than us for tax purposes and this could create conflicts of interest; and
- our joint venture partners may have competing interests in our markets that could create conflicts of interest.

**Our insurance coverage on our properties may be inadequate.** We carry insurance on all of our properties, including insurance for liability, fire, windstorms, floods, earthquakes, environmental concerns and business interruption. Insurance companies, however, limit or exclude coverage against certain types of losses, such as losses due to terrorist acts, named windstorms, earthquakes and toxic mold. Thus, we may not have insurance coverage, or sufficient insurance coverage, against certain types of losses and/or there may be decreases in the insurance coverage available. Should an uninsured loss or a loss in excess of our insured limits occur, we could lose all or a portion of the capital we have invested in a property or properties, as well as the anticipated future operating income from the property or properties. If any of our properties were to experience a catastrophic loss, it could disrupt our operations, delay revenue and result in large expenses to repair or rebuild the property. Further, if any of our insurance carriers were to become insolvent, we would be forced to replace the existing insurance coverage with another suitable carrier, and any outstanding claims would be at risk for collection. In such an event, we cannot be certain that we would be able to replace the coverage at similar or otherwise favorable terms. Such events could adversely affect our results of operations and financial condition.

We have obtained title insurance policies for each of our properties, typically in an amount equal to its original purchase price. However, these policies may be for amounts less than the current or future values of our properties, particularly for land parcels on which we subsequently construct a building. In such event, if there is a title defect relating to any of our properties, we could lose some of the capital invested in and anticipated profits from such property.

**Our use of debt to finance a portion of our operations could have a material adverse effect on our financial condition and results of operations.** We are subject to risks associated with debt financing, such as the sufficiency of cash flow to meet required payment obligations, ability to comply with financial ratios and other covenants and the availability of capital to refinance existing indebtedness or fund important business initiatives. If we breach covenants in our debt agreements, the lenders can declare a default and, if the debt is secured, can take possession of the property securing the defaulted loan. In addition, certain of our unsecured debt agreements contain cross-default provisions giving the unsecured lenders the right to declare a default if we are in default under more than \$25.0 million with respect to other loans in some circumstances. Unwaived defaults under our debt agreements could materially and adversely affect our financial condition and results of operations.

Further, we obtain credit ratings from Moody's Investors Service and Standard and Poor's Rating Services based on their evaluation of our creditworthiness. These agencies' ratings are based on a number of factors, some of which are not within our control. In addition to factors specific to our financial strength and performance, the rating agencies also consider conditions affecting REITs generally. We cannot assure you that our credit ratings will not be downgraded. If our credit ratings are downgraded or other negative action is taken, we could be required, among other things, to pay additional interest and fees on outstanding borrowings under our revolving credit facility and bank term loans.

We generally do not intend to reserve funds to retire existing debt upon maturity, which includes \$379.7 million principal amount of unsecured notes due March 15, 2017 and a \$109.1 million secured loan due November 1, 2017. We may not be able to repay, refinance or extend any or all of our debt at maturity or upon any acceleration. If any refinancing is done at higher interest rates, the increased interest expense could adversely affect our financial condition and results of operations. Any such refinancing could also impose tighter financial ratios and other covenants that restrict our ability to take actions that could otherwise be in our best interest, such as funding new development activity, making opportunistic acquisitions, repurchasing our securities or paying distributions. While we do not currently have significant amounts of mortgage debt, we may in the future mortgage additional properties, which could also restrict our ability to sell any such underlying assets. If we do not meet any such mortgage financing obligations, any properties securing such indebtedness could be foreclosed on.

We depend on our revolving credit facility for working capital purposes and for the short-term funding of our development and acquisition activity and, in certain instances, the repayment of other debt upon maturity. Our ability to borrow under the revolving credit facility also allows us to quickly capitalize on opportunities at short-term interest rates. If our lenders default under their obligations under the revolving credit facility or we become unable to borrow additional funds under the facility for any reason, we would be required to seek alternative equity or debt capital, which could be more costly and adversely impact our financial condition. If such alternative capital were unavailable, we may not be able to make new investments and could have difficulty repaying other debt.

**Increases in interest rates would increase our interest expense.** At December 31, 2016, we had \$475.0 million of variable rate debt outstanding not protected by interest rate hedge contracts. We may incur additional variable rate debt in the future. If interest rates increase, then so would the interest expense on our unhedged variable rate debt, which could adversely affect our financial condition and results of operations. From time to time, we manage our exposure to interest rate risk with interest rate hedge contracts that effectively fix or cap a portion of our variable rate debt. In addition, we utilize fixed rate debt at market rates. If interest rates decrease, the fair market value of any existing interest rate hedge contracts or outstanding fixed-rate debt would decline.



Our efforts to manage these exposures may not be successful. Our use of interest rate hedge contracts to manage risk associated with interest rate volatility may expose us to additional risks, including a risk that a counterparty to a hedge contract may fail to honor its obligations. Developing an effective interest rate risk strategy is complex and no strategy can completely insulate us from risks associated with interest rate fluctuations. There can be no assurance that our hedging activities will have the desired beneficial impact on our results of operations or financial condition. Termination of interest rate hedge contracts typically involves costs, such as transaction fees or breakage costs.

**Failure to comply with Federal government contractor requirements could result in substantial costs and loss of substantial revenue.** We are subject to compliance with a wide variety of complex legal requirements because we are a Federal government contractor. These laws regulate how we conduct business, require us to administer various compliance programs and require us to impose compliance responsibilities on some of our contractors. Our failure to comply with these laws could subject us to fines and penalties, cause us to be in default of our leases and other contracts with the Federal government and bar us from entering into future leases and other contracts with the Federal government.

**We face risks associated with security breaches through cyber attacks, cyber intrusions or otherwise, as well as other significant disruptions of our information technology (IT) networks and related systems.** We face risks associated with security breaches, whether through cyber attacks or cyber intrusions over the Internet, malware, computer viruses, attachments to e-mails, persons inside our organization or persons with access to systems inside our organization, and other significant disruptions of our IT networks and related systems. The risk of a security breach or disruption, particularly through cyber attack or cyber intrusion, including by computer hackers, foreign governments and cyber terrorists, has generally increased as the number, intensity and sophistication of attempted attacks and intrusions from around the world have increased. Our IT networks and related systems are essential to the operation of our business and our ability to perform day-to-day operations (including managing our building systems) and, in some cases, may be critical to the operations of certain of our customers. Although we make efforts to maintain the security and integrity of these types of IT networks and related systems, and we have implemented various measures to manage the risk of a security breach or disruption, there can be no assurance that our security efforts and measures will be effective or that attempted security breaches or disruptions would not be successful or damaging. Even the most well protected information, networks, systems and facilities remain potentially vulnerable because the techniques used in such attempted security breaches evolve and generally are not recognized until launched against a target, and in some cases are designed not to be detected and, in fact, may not be detected. Accordingly, we may be unable to anticipate these techniques or to implement adequate security barriers or other preventative measures, and thus it is impossible for us to entirely mitigate this risk.

A security breach or other significant disruption involving our IT networks and related systems could:

- disrupt the proper functioning of our networks and systems and therefore our operations and/or those of certain of our customers;
- result in misstated financial reports, violations of loan covenants, missed reporting deadlines and/or missed permitting deadlines;
- result in our inability to properly monitor our compliance with the rules and regulations regarding our qualification as a REIT;
- result in the unauthorized access to, and destruction, loss, theft, misappropriation or release of, proprietary, confidential, sensitive or otherwise valuable information of ours or others, which others could use to compete against us or which could expose us to damage claims by third-parties for disruptive, destructive or otherwise harmful purposes and outcomes;
- result in our inability to maintain the building systems relied upon by our customers for the efficient use of their leased space;
- require significant management attention and resources to remedy any damages that result;
- subject us to claims for breach of contract, damages, credits, penalties or termination of leases or other agreements; or
- damage our reputation among our customers and investors generally.

Any or all of the foregoing could have a material adverse effect on our results of operations, financial condition and cash flows.

**The Company may be subject to taxation as a regular corporation if it fails to maintain its REIT status, which could have a material adverse effect on the Company's stockholders and on the Operating Partnership.** We may be subject to adverse consequences if the Company fails to continue to qualify as a REIT for federal income tax purposes. While we intend to operate in a manner that will allow the Company to continue to qualify as a REIT, we cannot provide any assurances that the Company will remain qualified as such in the future, which could have particularly adverse consequences to the Company's stockholders. Many of the requirements for taxation as a REIT are highly technical and complex and depend upon various factual matters and circumstances that may not be entirely within our control. The fact that the Company holds its assets through the Operating Partnership and its subsidiaries further complicates the application of the REIT requirements. Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, Congress and the Internal Revenue Service might change the tax laws and regulations and the courts might issue new rulings that make it more difficult, or impossible, for the Company to remain qualified as a REIT. If the Company fails to qualify as a REIT, it would (a) not be allowed a deduction for dividends paid to stockholders in computing its taxable income, (b) be subject to federal income tax at regular corporate rates (and potentially the alternative minimum tax and increased state and local taxes) and (c) unless entitled to relief under the tax laws, not be able to re-elect REIT status until the fifth calendar year after it failed to qualify as a REIT. Additionally, the Company would no longer be required to make distributions. As a result of these factors, the Company's failure to qualify as a REIT could impair our ability to expand our business and adversely affect the price of our Common Stock.

**Even if we remain qualified as a REIT, we may face other tax liabilities that adversely affect our financial condition and results of operations.** Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, property and transfer taxes. In addition, our taxable REIT subsidiary is subject to regular corporate federal, state and local taxes. Any of these taxes would adversely affect our financial condition and results of operations.

**Complying with REIT requirements may cause us to forego otherwise attractive opportunities or liquidate otherwise attractive investments.** To remain qualified as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders and the ownership of our capital stock. In order to meet these tests, we may be required to forego investments we might otherwise make. Thus, compliance with the REIT requirements may hinder our performance.

In particular, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and qualified real estate assets. The remainder of our investment in securities (other than government securities, securities of taxable REIT subsidiaries and qualified real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities, securities of taxable REIT subsidiaries and qualified real estate assets) can consist of the securities of any one issuer, and no more than 25% of the value of our total assets can be represented by the securities of one or more taxable REIT subsidiaries. If we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate otherwise attractive investments, which could adversely affect our financial condition and results of operations.

**The prohibited transactions tax may limit our ability to sell properties.** A REIT's net income from prohibited transactions is subject to a 100% tax. In general, prohibited transactions are sales or other dispositions of property held primarily for sale to customers in the ordinary course of business. We may be subject to the prohibited transaction tax equal to 100% of net gain upon a disposition of real property. Although a safe harbor to the characterization of the sale of real property by a REIT as a prohibited transaction is available, we cannot assure you that we can in all cases comply with the safe harbor or that we will avoid owning property that may be characterized as held primarily for sale to customers in the ordinary course of business. Consequently, we may choose not to engage in certain sales of our properties or may conduct such sales through our taxable REIT subsidiary, which would be subject to federal and state income taxation.

**Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.** The maximum tax rate applicable to "qualified dividend income" payable to U.S. stockholders that are taxed at individual rates is 20%. Dividends payable by REITs, however, generally are not eligible for the reduced rates on qualified dividend income. The more favorable rates applicable to regular corporate qualified dividends could cause investors who are taxed at individual rates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the shares of REITs, including our stock.

**We face possible state and local tax audits.** Because we are organized and qualify as a REIT, we are generally not subject to federal income taxes, but we are subject to certain state and local taxes. In the normal course of business, certain entities through which we own real estate have undergone tax audits. Collectively, tax deficiency notices received to date from the jurisdictions conducting previous audits have not been material. However, there can be no assurance that future audits will not occur with increased frequency or that the ultimate result of such audits will not have a material adverse effect on our results of operations.

**The price of our Common Stock is volatile and may decline.** A number of factors may adversely influence the public market price of our Common Stock. These factors include:

- the level of institutional interest in us;
- the perceived attractiveness of investment in us, in comparison to other REITs;
- the attractiveness of securities of REITs in comparison to other asset classes;
- our financial condition and performance;
- the market's perception of our growth potential and potential future cash dividends;
- government action or regulation, including changes in tax laws;
- increases in market interest rates, which may lead investors to expect a higher annual yield from our distributions in relation to the price of our Common Stock;
- changes in our credit ratings;
- the issuance of additional shares of Common Stock, or the perception that such issuances might occur, including under our equity distribution agreements; and
- any negative change in the level or stability of our dividend.

**Tax elections regarding distributions may impact the future liquidity of the Company or our stockholders.** Under certain circumstances, we may consider making a tax election to treat future distributions to stockholders as distributions in the current year. This election, which is provided for in the Internal Revenue Code, may allow us to avoid increasing our dividends or paying additional income taxes in the current year. However, this could result in a constraint on our ability to decrease our dividends in future years without creating risk of either violating the REIT distribution requirements or generating additional income tax liability.

**We may face risks in connection with Section 1031 exchanges.** If a transaction's gain that is intended to qualify as a Section 1031 deferral is later determined to be taxable, we may face adverse consequences, and if the laws applicable to such transactions are amended or repealed, we may not be able to dispose of properties on a tax-deferred basis.

**Tax legislative or regulatory action could adversely affect us or our stockholders.** In recent years, numerous legislative, judicial and administrative changes have been made to the U.S. federal income tax laws applicable to investments similar to an investment in our Common Stock. Additional changes to tax laws are likely to continue in the future, and we cannot assure you that any such changes will not adversely affect the taxation of us or our stockholders. Any such changes could have an adverse effect on an investment in our Common Stock or on the market value of our properties.

**We cannot assure you that we will continue to pay dividends at historical rates.** We generally expect to use cash flows from operating activities to fund dividends. The following factors will affect such cash flows and, accordingly, influence the decisions of the Company's board of directors regarding dividends:

- projections with respect to the future REIT taxable income expected to be generated by the Company;
- debt service requirements after taking into account debt covenants and the repayment and restructuring of certain indebtedness and the availability of alternative sources of debt and equity capital and their impact on our ability to refinance existing debt and grow our business;
- scheduled increases in base rents of existing leases;

- changes in rents attributable to the renewal of existing leases or replacement leases;
- changes in occupancy rates at existing properties and execution of leases for newly acquired or developed properties;
- changes in operating expenses;
- anticipated leasing capital expenditures attributable to the renewal of existing leases or replacement leases;
- anticipated building improvements; and
- expected cash flows from financing and investing activities, including from the sales of assets generating taxable gains to the extent such assets are not sold in a tax-deferred exchange under Section 1031 of the Internal Revenue Code or another tax-free or tax-deferred transaction.

The decision to declare and pay dividends on our Common Stock in the future, as well as the timing, amount and composition of any such future dividends, will be at the sole discretion of the Company's board of directors. Changes in our future dividend payout level could have a material effect on the market price of our Common Stock.

**Cash distributions reduce the amount of cash that would otherwise be available for other business purposes, including funding debt maturities, reducing debt or future growth initiatives.** For the Company to maintain its qualification as a REIT, it must annually distribute to its stockholders at least 90% of REIT taxable income, excluding net capital gains. In addition, although capital gains are not required to be distributed to maintain REIT status, taxable capital gains, if any, that are generated as part of our capital recycling program are subject to federal and state income tax unless such gains are distributed to our stockholders. Cash distributions made to stockholders to maintain REIT status or to distribute otherwise taxable capital gains limit our ability to accumulate capital for other business purposes, including funding debt maturities, reducing debt or growth initiatives.

**Further issuances of equity securities may adversely affect the market price of our Common Stock and may be dilutive to current stockholders.** The sales of a substantial number of Common Shares, or the perception that such sales could occur, could adversely affect the market price of our Common Stock. The Company's board of directors may authorize the issuance of additional authorized but unissued Common Shares or other authorized but unissued securities at any time. We have filed a registration statement with the SEC allowing us to offer, from time to time, an indefinite amount of equity securities (including Common Stock and Preferred Stock) on an as-needed basis and subject to our ability to effect offerings on satisfactory terms based on prevailing conditions. In addition, the Company's board of directors has, from time to time, authorized the Company to issue shares of Common Stock pursuant to the Company's equity sales agreements. The interests of our existing stockholders could be diluted if additional equity securities are issued to finance future developments and acquisitions or repay indebtedness. Our ability to execute our business strategy depends on our access to an appropriate blend of debt financing, including unsecured lines of credit and other forms of secured and unsecured debt, and equity financing, including common equity.

**We may change our policies without obtaining the approval of our stockholders.** Our operating and financial policies, including our policies with respect to acquisitions of real estate, growth, operations, indebtedness, capitalization and dividends, are exclusively determined by the Company's Board of Directors. Accordingly, our stockholders do not control these policies.

**Limits on changes in control may discourage takeover attempts beneficial to stockholders.** Provisions in the Company's charter and bylaws as well as Maryland general corporation law may have anti-takeover effects that delay, defer or prevent a takeover attempt. For example, these provisions may defer or prevent tender offers for our Common Stock or purchases of large blocks of our Common Stock, thus limiting the opportunities for the Company's stockholders to receive a premium for their shares of Common Stock over then-prevailing market prices. These provisions include the following:

- **Ownership limit.** The Company's charter prohibits direct, indirect or constructive ownership by any person or entity of more than 9.8% of the Company's outstanding capital stock. Any attempt to own or transfer shares of capital stock in excess of the ownership limit without the consent of the Company's board of directors will be void.
- **Preferred Stock.** The Company's charter authorizes the board of directors to issue preferred stock in one or more classes and establish the preferences and rights of any class of preferred stock issued. These actions can be taken without stockholder approval. The issuance of preferred stock could have the effect of delaying or preventing someone from taking control of the Company, even if a change in control were in our best interest.
- **Business combinations.** Pursuant to the Company's charter and Maryland law, the Company cannot merge into or consolidate with another corporation or enter into a statutory share exchange transaction in which the Company is not

the surviving entity or sell all or substantially all of its assets unless the board of directors adopts a resolution declaring the proposed transaction advisable and a majority of the stockholders voting together as a single class approve the transaction. Maryland law prohibits stockholders from taking action by written consent unless all stockholders consent in writing. The practical effect of this limitation is that any action required or permitted to be taken by the Company's stockholders may only be taken if it is properly brought before an annual or special meeting of stockholders. The Company's bylaws further provide that in order for a stockholder to properly bring any matter before a meeting, the stockholder must comply with requirements regarding advance notice. The foregoing provisions could have the effect of delaying until the next annual meeting stockholder actions that the holders of a majority of the Company's outstanding voting securities favor. These provisions may also discourage another person from making a tender offer for the Company's common stock, because such person or entity, even if it acquired a majority of the Company's outstanding voting securities, would likely be able to take action as a stockholder, such as electing new directors or approving a merger, only at a duly called stockholders meeting. Maryland law also establishes special requirements with respect to business combinations between Maryland corporations and interested stockholders unless exemptions apply. Among other things, the law prohibits for five years a merger and other similar transactions between a corporation and an interested stockholder and requires a supermajority vote for such transactions after the end of the five-year period. The Company's charter contains a provision exempting the Company from the Maryland business combination statute. However, we cannot assure you that this charter provision will not be amended or repealed at any point in the future.

- **Control share acquisitions.** Maryland general corporation law also provides that control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast on the matter, excluding shares owned by the acquirer or by officers or employee directors. The control share acquisition statute does not apply to shares acquired in a merger, consolidation or share exchange if the corporation is a party to the transaction, or to acquisitions approved or exempted by the corporation's charter or bylaws. The Company's bylaws contain a provision exempting from the control share acquisition statute any stock acquired by any person. However, we cannot assure you that this bylaw provision will not be amended or repealed at any point in the future.
- **Maryland unsolicited takeover statute.** Under Maryland law, the Company's board of directors could adopt various anti-takeover provisions without the consent of stockholders. The adoption of such measures could discourage offers for the Company or make an acquisition of the Company more difficult, even when an acquisition would be in the best interest of the Company's stockholders.
- **Anti-takeover protections of operating partnership agreement.** Upon a change in control of the Company, the partnership agreement of the Operating Partnership requires certain acquirers to maintain an umbrella partnership real estate investment trust structure with terms at least as favorable to the limited partners as are currently in place. For instance, the acquirer would be required to preserve the limited partner's right to continue to hold tax-deferred partnership interests that are redeemable for capital stock of the acquirer. Exceptions would require the approval of two-thirds of the limited partners of our Operating Partnership (other than the Company). These provisions may make a change of control transaction involving the Company more complicated and therefore might decrease the likelihood of such a transaction occurring, even if such a transaction would be in the best interest of the Company's stockholders.

#### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

## ITEM 2. PROPERTIES

Our core portfolio consists primarily of office properties in Raleigh, Atlanta, Tampa, Nashville, Memphis, Pittsburgh, Richmond and Orlando and office and industrial properties in Greensboro.

### Properties

The following table sets forth information about in-service office properties that we wholly own by geographic location at December 31, 2016:

Market	Rentable Square Feet	Occupancy	Percentage of Annualized Cash Rental Revenue (1)
Atlanta	5,239,000	92.1 %	19.7 %
Raleigh	5,096,000	92.7	18.0
Nashville	3,338,000	99.6	14.6
Tampa	3,822,000	90.9	13.7
Pittsburgh	2,162,000	93.8	8.9
Memphis	2,208,000	89.8	7.9
Orlando	1,977,000	88.2	7.6
Richmond	1,942,000	94.6	5.9
Greensboro	1,151,000	93.2	3.5
Kansas City	67,000	95.6	0.2
<b>Total</b>	<b>27,002,000</b>	<b>92.9%</b>	<b>100.0%</b>

- (1) Annualized Cash Rental Revenue is cash rental revenue (base rent plus cost recovery income, excluding straight-line rent) from our office properties for the month of December 2016 multiplied by 12.

The following table sets forth the net changes in rentable square footage of in-service properties that we wholly own:

	Year Ended December 31,		
	2016	2015	2014
	(rentable square feet in thousands)		
Acquisitions	243	1,592	686
Developments Placed In-Service	176	503	282
Redevelopment/Other	(46)	14	(19)
Dispositions	(1,429)	(175)	(1,645)
<b>Net Change in Rentable Square Footage</b>	<b>(1,056)</b>	<b>1,934</b>	<b>(696)</b>

The following table sets forth operating information about in-service properties that we wholly own:

	Average Occupancy	Annualized GAAP Rent Per Square Foot (1)	Annualized Cash Rent Per Square Foot (2)
2012	90.3%	\$ 17.90	\$ 18.42
2013	90.0%	\$ 21.42	\$ 20.48
2014	90.4%	\$ 22.13	\$ 21.29
2015	92.3%	\$ 23.30	\$ 22.55
2016	92.8%	\$ 23.24	\$ 22.55

- (1) Annualized GAAP Rent Per Square Foot is rental revenue (base rent plus cost recovery income, including straight-line rent) for the month of December of the respective year multiplied by 12, divided by total occupied rentable square footage.
- (2) Annualized Cash Rent Per Square Foot is cash rental revenue (base rent plus cost recovery income, excluding straight-line rent) for the month of December of the respective year multiplied by 12, divided by total occupied rentable square footage.



## Customers

The following table sets forth information concerning the 20 largest customers of properties that we wholly own at December 31, 2016:

Customer	Rentable Square Feet	Annualized Cash Rental Revenue (1)	Percent of Total Annualized Cash Rental Revenue (1)	Weighted Average Remaining Lease Term in Years
	(in thousands)			
Federal Government	1,418,042	\$ 34,369	5.52 %	4.4
Metropolitan Life Insurance	661,060	16,369	2.63	10.2
PPG Industries	356,215	9,721	1.56	14.3
HCA Corporation	297,909	8,064	1.29	0.3
EQT Corporation	319,269	7,512	1.21	7.8
Healthways	263,598	6,903	1.11	6.2
International Paper	278,444	6,457	1.04	11.9
Bass, Berry & Sims	195,846	6,356	1.02	8.1
State of Georgia	318,506	6,222	1.00	4.0
Willis Towers Watson	239,506	6,172	0.99	5.1
Novelis	168,949	5,577	0.89	7.7
Marsh USA	175,390	5,474	0.88	5.2
Aon	190,683	5,408	0.87	2.9
PNC Bank	187,076	5,364	0.86	9.9
Vanderbilt University	209,989	5,216	0.84	3.8
Syniverse Technologies	218,678	4,906	0.79	9.8
Lifepoint Corporate Services	202,991	4,691	0.75	12.3
Morgan Stanley	144,616	4,642	0.74	2.8
AT&T	197,826	4,571	0.73	2.6
SunTrust	141,735	4,345	0.70	3.3
<b>Total</b>	<b>6,186,328</b>	<b>\$ 158,339</b>	<b>25.42%</b>	<b>6.6</b>

(1) Annualized Cash Rental Revenue is cash rental revenue (base rent plus cost recovery income, excluding straight-line rent) for the month of December 2016 multiplied by 12.

## Lease Expirations

The following tables set forth scheduled lease expirations for existing leases at office properties that we wholly owned at December 31, 2016:

Lease Expiring (1)	Number of Leases Expiring	Rentable Square Feet Subject to Expiring Leases	Percentage of Leased Square Footage Represented by Expiring Leases	Annualized Cash Rental Revenue Under Expiring Leases (2)	Average Annual Cash Rental Rate Per Square Foot for Expirations	Percent of Annualized Cash Rental Revenue Represented by Expiring Leases (2)
(\$ in thousands)						
2017 (3)	435	2,319,501	9.3%	\$ 59,525	\$ 25.66	9.8%
2018	399	2,735,958	10.9	66,598	24.34	11.0
2019	364	3,535,333	14.0	85,950	24.31	14.3
2020	295	2,754,909	11.0	73,892	26.82	12.2
2021	253	2,767,479	11.0	64,430	23.28	10.7
2022	143	1,710,029	6.8	39,457	23.07	6.5
2023	81	1,614,168	6.4	37,364	23.15	6.2
2024	66	1,769,755	7.1	43,016	24.31	7.1
2025	44	947,576	3.8	26,392	27.85	4.4
2026	66	1,245,338	5.0	28,625	22.99	4.7
Thereafter	168	3,673,904	14.7	79,502	21.64	13.1
	<b>2,314</b>	<b>25,073,950</b>	<b>100.0%</b>	<b>\$ 604,751</b>	<b>\$ 24.12</b>	<b>100.0%</b>

- Expirations that have been renewed are reflected above based on the renewal expiration date. Expirations include leases related to completed not stabilized development properties but exclude leases related to developments in-process.
- Annualized Cash Rental Revenue is cash rental revenue (base rent plus cost recovery income, excluding straight-line rent) for the month of December 2016 multiplied by 12.
- Includes 62,000 rentable square feet of leases that are on a month-to-month basis, which represent 0.3% of total annualized cash rental revenue.

## In-Process Development

As of December 31, 2016, we were developing 1.2 million rentable square feet of office properties. The following table summarizes these announced and in-process office developments:

Property	Market	Rentable Square Feet	Anticipated Total Investment (1)	Investment As Of December 31, 2016 (1)	Pre - Leased %	Estimated Completion	Estimated Stabilization
(\$ in thousands)							
Bridgestone Americas	Nashville	514,000	\$ 200,000	\$ 135,856	100.0%	3Q17	3Q17
Riverwood 200	Atlanta	299,000	107,000	76,583	72.7	2Q17	2Q19
Seven Springs II	Nashville	131,000	38,100	25,288	52.3	2Q17	3Q18
5000 CentreGreen	Raleigh	166,500	40,850	15,365	—	3Q17	3Q19
Virginia Urology (2)	Richmond	87,000	29,140	1,479	100.0	3Q18	3Q18
		<b>1,197,500</b>	<b>\$ 415,090</b>	<b>\$ 254,571</b>	<b>74.1%</b>		

- Includes deferred lease commissions which are classified in deferred leasing costs on our Consolidated Balance Sheets.
- Recorded on our Consolidated Balance Sheets in land held for development, not development in-process.

## Land Held for Development

We wholly owned 431 acres of development land at December 31, 2016. We estimate that we can develop approximately 4.6 million and 0.4 million rentable square feet of office and industrial space, respectively, on the 235 acres that we consider core assets for our future development needs. Our core development land is zoned and available for development, and nearly all of the land has utility infrastructure in place. We believe that our commercially zoned and unencumbered land gives us a development advantage over other commercial real estate development companies in many of our markets.

## Joint Venture Investments

The following table sets forth information about our joint venture investments by geographic location at December 31, 2016:

Market	Rentable Square Feet	Weighted Average Ownership Interest (1)	Occupancy	Percentage of Annualized Cash Rental Revenue (2)
Kansas City (3)	292,000	50.0%	99.5%	39.3%
Raleigh	635,000	25.0	93.5	29.8
Richmond (4)	345,000	50.0	100.0	21.1
Orlando	306,000	28.0	100.0	9.8
<b>Total</b>	<b>1,578,000</b>	<b>35.7%</b>	<b>97.3%</b>	<b>100.0%</b>

- (1) Weighted Average Ownership Interest is calculated using Rentable Square Feet.
- (2) Annualized Cash Rental Revenue is cash rental revenue (base rent plus cost recovery income, excluding straight-line rent) for the month of December 2016 multiplied by 12.
- (3) Excluding our 26.5% ownership interest in a real estate brokerage services company.
- (4) This joint venture is consolidated.

## ITEM 3. LEGAL PROCEEDINGS

We are from time to time a party to a variety of legal proceedings, claims and assessments arising in the ordinary course of our business. We regularly assess the liabilities and contingencies in connection with these matters based on the latest information available. For those matters where it is probable that we have incurred or will incur a loss and the loss or range of loss can be reasonably estimated, the estimated loss is accrued and charged to income in our Consolidated Financial Statements. In other instances, because of the uncertainties related to both the probable outcome and amount or range of loss, a reasonable estimate of liability, if any, cannot be made. Based on the current expected outcome of such matters, none of these proceedings, claims or assessments is expected to have a material adverse effect on our business, financial condition, results of operations or cash flows.

## ITEM X. EXECUTIVE OFFICERS OF THE REGISTRANT

The Company is the sole general partner of the Operating Partnership. The following table sets forth information with respect to the Company's executive officers:

Name	Age	Position and Background
Edward J. Fritsch	58	<p>Director, President and Chief Executive Officer.</p> <p>Mr. Fritsch has been a director since January 2001. Mr. Fritsch became our chief executive officer and chair of the investment committee of our board of directors on July 1, 2004 and our president in December 2003. Prior to that, Mr. Fritsch was our chief operating officer from January 1998 to July 2004 and was a vice president and secretary from June 1994 to January 1998. Mr. Fritsch joined our predecessor in 1982 and was a partner of that entity at the time of our initial public offering in June 1994. Mr. Fritsch currently serves as a director and member of the audit and compensation committees of National Retail Properties, Inc., a publicly-traded REIT (NYSE:NNN). Mr. Fritsch is immediate past chair of the National Association of Real Estate Investment Trusts ("NAREIT") and currently serves on its executive board and chairs its governance committee. Mr. Fritsch is also a member of Wells Fargo's central region advisory board, a member of the University of North Carolina at Chapel Hill Foundation board, a director of the University of North Carolina at Chapel Hill Real Estate Holdings and a member of the Dix Park Conservancy board.</p>
Theodore J. Klinck	51	<p>Executive Vice President and Chief Operating and Investment Officer.</p> <p>Mr. Klinck became executive vice president and chief operating and investment officer in September 2015. Prior to that, Mr. Klinck was our senior vice president and chief investment officer since March 2012. Before joining us, Mr. Klinck served as principal and chief investment officer with Goddard Investment Group, a privately owned real estate investment firm. Previously, Mr. Klinck had been a managing director at Morgan Stanley Real Estate.</p>
Mark F. Mulhern	57	<p>Executive Vice President and Chief Financial Officer.</p> <p>Mr. Mulhern became chief financial officer in September 2014. Prior to that, Mr. Mulhern was a director of the Company since January 2012. Mr. Mulhern served as executive vice president and chief financial officer of Exco Resources, Inc. (NYSE:XCO), an oil and gas exploration and production company, from 2013 until September 2014. Mr. Mulhern served as senior vice president and chief financial officer of Progress Energy, Inc. (NYSE:PGN) from 2008 until its merger with Duke Energy Corporation (NYSE:DUK) in July 2012. Mr. Mulhern first joined Progress Energy in 1996 and served in a number of financial and strategic roles. He also spent eight years at Price Waterhouse. Mr. Mulhern currently serves as a director of Azure Midstream Partners, a publicly-traded energy company (NYSE:AZUR), McKim and Creed, a private engineering services firm and Triangle Capital Corporation (NYSE:TCAP), a leading provider of capital to lower middle market companies. Mr. Mulhern is a certified public accountant, a certified management accountant and a certified internal auditor.</p>
Jeffrey D. Miller	46	<p>Executive Vice President, General Counsel and Secretary.</p> <p>Prior to joining us in March 2007, Mr. Miller was a partner with DLA Piper US, LLP, where he practiced since 2005. Previously, Mr. Miller had been a partner with Alston &amp; Bird LLP. Mr. Miller is admitted to practice in North Carolina. Mr. Miller served as lead independent director of Hatteras Financial Corp., a publicly-traded mortgage REIT (NYSE:HTS), prior to its merger with Annaly Capital Management, Inc. (NYSE:NLY) in July 2016.</p>

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The following table sets forth high and low stock prices per share reported on the NYSE and dividends declared per share of Common Stock:

Quarter Ended	2016			2015		
	High	Low	Dividend	High	Low	Dividend
March 31	\$ 48.14	\$ 38.08	\$ 0.425	\$ 48.34	\$ 43.09	\$ 0.425
June 30	\$ 52.86	\$ 44.93	\$ 0.425	\$ 47.10	\$ 39.72	\$ 0.425
September 30	\$ 56.23	\$ 50.05	\$ 0.425	\$ 42.78	\$ 36.57	\$ 0.425
December 31 (1)	\$ 52.03	\$ 45.83	\$ 1.225	\$ 44.61	\$ 38.18	\$ 0.425

- (1) Includes a special cash dividend of \$0.80 per share declared in the quarter ended December 31, 2016 and paid January 10, 2017. The principal purpose of the special dividend was to distribute taxable capital gains associated with the sales of substantially all of our wholly-owned Country Club Plaza assets in Kansas City (which we refer to as the "Plaza assets") during the first quarter of 2016.

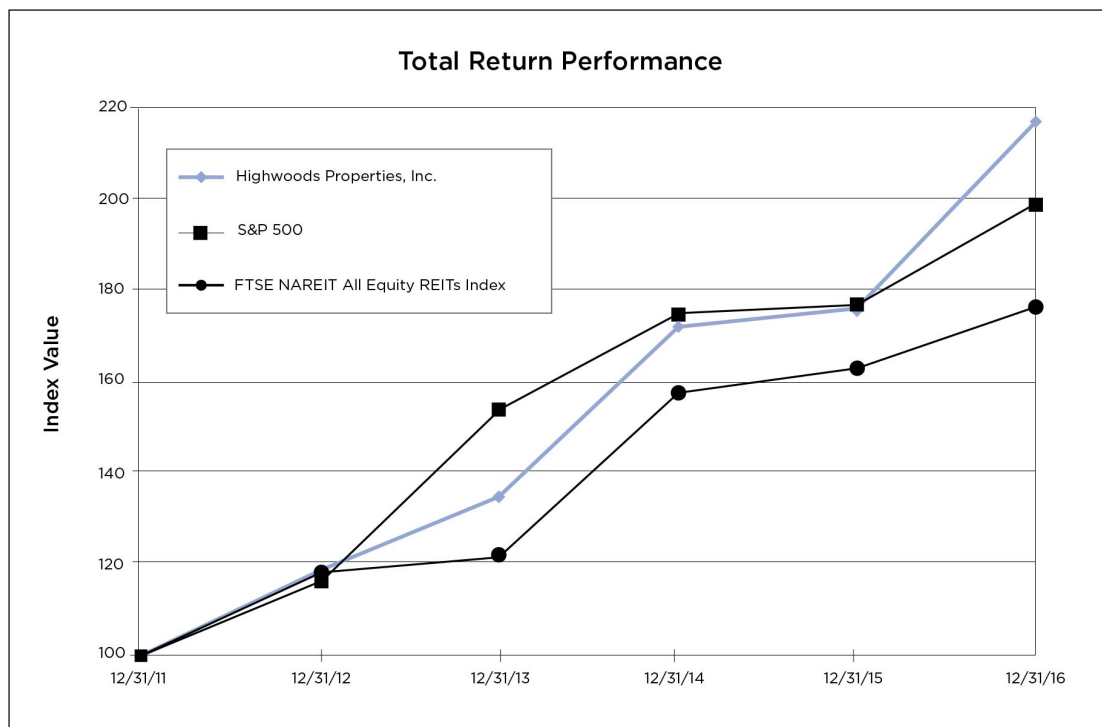
On December 31, 2016, the last reported stock price of our Common Stock on the NYSE was \$51.01 per share and the Company had 889 common stockholders of record. There is no public trading market for the Common Units. On December 31, 2016, the Operating Partnership had 103 holders of record of Common Units (other than the Company). At December 31, 2016, there were 101.7 million shares of Common Stock outstanding and 2.8 million Common Units outstanding not owned by the Company.

Because the Company is a REIT, the partnership agreement requires the Operating Partnership to distribute at least enough cash for the Company to be able to distribute to its stockholders at least 90.0% of its REIT taxable income, excluding net capital gains. See "Item 1A. Risk Factors – Cash distributions reduce the amount of cash that would otherwise be available for other business purposes, including funding debt maturities, reducing debt or future growth initiatives."

We generally expect to use cash flows from operating activities to fund distributions. The following factors will affect such cash flows and, accordingly, influence the decisions of the Company's Board of Directors regarding dividends and distributions:

- projections with respect to the future REIT taxable income expected to be generated by the Company;
- debt service requirements after taking into account debt covenants and the repayment and restructuring of certain indebtedness and the availability of alternative sources of debt and equity capital and their impact on our ability to refinance existing debt and grow our business;
- scheduled increases in base rents of existing leases;
- changes in rents attributable to the renewal of existing leases or replacement leases;
- changes in occupancy rates at existing properties and execution of leases for newly acquired or developed properties;
- changes in operating expenses;
- anticipated leasing capital expenditures attributable to the renewal of existing leases or replacement leases;
- anticipated building improvements; and
- expected cash flows from financing and investing activities, including from the sales of assets generating taxable gains to the extent such assets are not sold in a tax-deferred exchange under Section 1031 of the Internal Revenue Code or another tax-free or tax-deferred transaction.

The following stock price performance graph compares the performance of our Common Stock to the S&P 500 and the FTSE NAREIT All Equity REITs Index. The stock price performance graph assumes an investment of \$100 in our Common Stock and the two indices on December 31, 2011 and further assumes the reinvestment of all dividends. The FTSE NAREIT All Equity REITs Index is a free-float adjusted, market capitalization-weighted index of U.S. equity REITs. Constituents of the Index include all tax-qualified REITs with more than 50% of total assets in qualifying real estate assets other than mortgages secured by real property. Stock price performance is not necessarily indicative of future results.



Index	For the Period from December 31, 2011 to December 31,				
	2012	2013	2014	2015	2016
Highwoods Properties, Inc.	118.74	134.49	171.71	175.84	216.68
S&P 500	116.00	153.57	174.60	177.01	198.18
FTSE NAREIT All Equity REITs Index	118.06	120.97	157.43	162.46	176.30

The performance graph above is being furnished as part of this Annual Report solely in accordance with the requirement under Rule 14a-3(b)(9) to furnish the Company’s stockholders with such information and, therefore, is not deemed to be filed, or incorporated by reference in any filing, by the Company or the Operating Partnership under the Securities Act of 1933 or the Securities Exchange Act of 1934.

During 2016, cash dividends declared on Common Stock totaled \$2.50 per share, which included a special cash dividend of \$0.80 per share declared in the quarter ended December 31, 2016 and paid January 10, 2017. Of the cash dividends declared in 2016, approximately \$1.29 per share represented 2016 capital gains, approximately \$1.15 per share represented 2016 ordinary dividends and approximately \$0.06 per share will be recognized as a 2017 distribution for federal income tax purposes. The minimum dividend per share of Common Stock required for the Company to maintain its REIT status was \$0.99 per share in 2016.

During the fourth quarter of 2016, the Company issued an aggregate of 1,000 shares of Common Stock to holders of Common Units in the Operating Partnership upon the redemption of a like number of Common Units in private offerings exempt from the registration requirements pursuant to Section 4(2) of the Securities Act. Each of the holders of Common Units was an accredited investor under Rule 501 of the Securities Act. The resale of such shares was registered by the Company under the Securities Act.

The Company has a Dividend Reinvestment and Stock Purchase Plan (“DRIP”) under which holders of Common Stock may elect to automatically reinvest their dividends in additional shares of Common Stock and make optional cash payments for additional



shares of Common Stock. The Company satisfies its DRIP obligations by instructing the DRIP administrator to purchase Common Stock in the open market.

The Company has an Employee Stock Purchase Plan ("ESPP") pursuant to which employees may contribute up to 25% of their cash compensation for the purchase of Common Stock. At the end of each three-month offering period, each participant's account balance, which includes accumulated dividends, is applied to acquire shares of Common Stock at a cost that is calculated at 85% of the average closing price on the NYSE on the five consecutive days preceding the last day of the quarter. The Company satisfies its ESPP obligations by issuing additional shares of Common Stock.

Information about the Company's equity compensation plans and other related stockholder matters is incorporated herein by reference to the Company's Proxy Statement to be filed in connection with its annual meeting of stockholders to be held on May 10, 2017.

## ITEM 6. SELECTED FINANCIAL DATA

Operating results for the years ended December 31, 2014, 2013 and 2012 were retrospectively revised from previously reported amounts to reclassify the operations for those properties classified as discontinued operations. Total assets and mortgages and notes payable, net as of the years ended December 31, 2015, 2014, 2013 and 2012 were retrospectively revised from previously reported amounts to reclassify debt issuance costs as a direct deduction from the carrying amount of the debt liability to which they relate as opposed to being presented as assets.

The information in the following tables should be read in conjunction with the Company's Consolidated Financial Statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included herein (\$ in thousands, except per share data):

	Year Ended December 31,				
	2016	2015	2014	2013	2012
<b>Rental and other revenues</b>	\$ 665,634	\$ 604,671	\$ 555,871	\$ 505,008	\$ 434,890
<b>Income from continuing operations</b>	\$ 122,546	\$ 85,521	\$ 96,987	\$ 42,641	\$ 21,578
<b>Income from discontinued operations</b>	\$ 418,593	\$ 15,739	\$ 18,985	\$ 88,456	\$ 62,657
<b>Income from continuing operations available for common stockholders</b>	\$ 115,461	\$ 79,308	\$ 90,069	\$ 37,890	\$ 17,394
<b>Net income</b>	\$ 541,139	\$ 101,260	\$ 115,972	\$ 131,097	\$ 84,235
<b>Net income available for common stockholders</b>	\$ 521,789	\$ 94,572	\$ 108,457	\$ 122,949	\$ 77,087
<b>Earnings per Common Share – basic:</b>					
Income from continuing operations available for common stockholders	\$ 1.17	\$ 0.84	\$ 1.00	\$ 0.44	\$ 0.23
Net income available for common stockholders	\$ 5.30	\$ 1.00	\$ 1.20	\$ 1.44	\$ 1.02
<b>Earnings per Common Share – diluted:</b>					
Income from continuing operations available for common stockholders	\$ 1.17	\$ 0.84	\$ 0.99	\$ 0.44	\$ 0.23
Net income available for common stockholders	\$ 5.30	\$ 1.00	\$ 1.19	\$ 1.44	\$ 1.02
<b>Dividends declared per Common Share (1)</b>	\$ 2.50	\$ 1.70	\$ 1.70	\$ 1.70	\$ 1.70

	December 31,				
	2016	2015	2014	2013	2012
Total assets	\$ 4,561,050	\$ 4,485,631	\$ 3,990,702	\$ 3,793,177	\$ 3,334,443
Mortgages and notes payable, net	\$ 1,948,047	\$ 2,491,813	\$ 2,062,968	\$ 1,948,161	\$ 1,848,963

(1) Includes a special cash dividend of \$0.80 per share declared in the quarter ended December 31, 2016 and paid January 10, 2017.

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

You should read the following discussion and analysis in conjunction with the accompanying Consolidated Financial Statements and related notes contained elsewhere herein.

### **Disclosure Regarding Forward-Looking Statements**

Some of the information in this Annual Report may contain forward-looking statements. Such statements include, in particular, statements about our plans, strategies and prospects under this section and under the heading "Item 1. Business." You can identify forward-looking statements by our use of forward-looking terminology such as "may," "will," "expect," "anticipate," "estimate," "continue" or other similar words. Although we believe that our plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, we cannot assure you that our plans, intentions or expectations will be achieved. When considering such forward-looking statements, you should keep in mind the following important factors that could cause our actual results to differ materially from those contained in any forward-looking statement:

- the financial condition of our customers could deteriorate;
- we may not be able to lease or re-lease second generation space, defined as previously occupied space that becomes available for lease, quickly or on as favorable terms as old leases;
- we may not be able to lease our newly constructed buildings as quickly or on as favorable terms as originally anticipated;
- we may not be able to complete development, acquisition, reinvestment, disposition or joint venture projects as quickly or on as favorable terms as anticipated;
- development activity by our competitors in our existing markets could result in an excessive supply relative to customer demand;
- our markets may suffer declines in economic growth;
- unanticipated increases in interest rates could increase our debt service costs;
- unanticipated increases in operating expenses could negatively impact our operating results;
- we may not be able to meet our liquidity requirements or obtain capital on favorable terms to fund our working capital needs and growth initiatives or repay or refinance outstanding debt upon maturity; and
- the Company could lose key executive officers.

This list of risks and uncertainties, however, is not intended to be exhaustive. You should also review the other cautionary statements we make in "Item 1A. Business – Risk Factors" set forth in this Annual Report. Given these uncertainties, you should not place undue reliance on forward-looking statements. We undertake no obligation to publicly release the results of any revisions to these forward-looking statements to reflect any future events or circumstances or to reflect the occurrence of unanticipated events.

## Executive Summary

Our Strategic Plan focuses on:

- owning high-quality, differentiated office buildings in the BBDs of our core markets;
- improving the operating results of our properties through concentrated leasing, asset management, cost control and customer service efforts;
- developing and acquiring office buildings in BBDs that improve the overall quality of our portfolio and generate attractive returns over the long term for our stockholders;
- disposing of properties no longer considered to be core assets primarily due to location, age, quality and/or overall strategic fit; and
- maintaining a balance sheet with ample liquidity to meet our funding needs and growth prospects.

### Revenues

Our operating results depend heavily on successfully leasing and operating the office space in our portfolio. Economic growth and employment levels in our core markets are and will continue to be important factors in predicting our future operating results.

The key components affecting our rental and other revenues are average occupancy, rental rates, cost recovery income, new developments placed in service, acquisitions and dispositions. Average occupancy generally increases during times of improving economic growth, as our ability to lease space outpaces vacancies that occur upon the expirations of existing leases. Average occupancy generally declines during times of slower economic growth, when new vacancies tend to outpace our ability to lease space. Asset acquisitions, dispositions and new developments placed in service directly impact our rental revenues and could impact our average occupancy, depending upon the occupancy rate of the properties that are acquired, sold or placed in service. A further indicator of the predictability of future revenues is the expected lease expirations of our portfolio. As a result, in addition to seeking to increase our average occupancy by leasing current vacant space, we also concentrate our leasing efforts on renewing existing leases prior to expiration. For more information regarding our lease expirations, see “Item 2. Properties - Lease Expirations.” Occupancy in our office portfolio increased from 92.6% at December 31, 2015 to 92.9% at December 31, 2016 primarily due to the net impact of our leasing activity in 2016.

Whether or not our rental revenue tracks average occupancy proportionally depends upon whether GAAP rents under signed new and renewal leases are higher or lower than the GAAP rents under expiring leases. Annualized rental revenues from second generation leases expiring during any particular year are typically less than 15% of our total annual rental revenues. The following table sets forth information regarding second generation office leases signed during the fourth quarter of 2016 (we define second generation office leases as leases with new customers and renewals of existing customers in office space that has been previously occupied under our ownership and leases with respect to vacant space in acquired buildings):

	New	Renewal	All Office
Leased space (in rentable square feet)	266,025	460,308	726,333
Average term (in years - rentable square foot weighted)	7.8	5.0	6.0
Base rents (per rentable square foot) (1)	\$ 29.05	\$ 26.64	\$ 27.52
Rent concessions (per rentable square foot) (1)	(1.02)	(0.30)	(0.56)
GAAP rents (per rentable square foot) (1)	\$ 28.03	\$ 26.34	\$ 26.96
Tenant improvements (per rentable square foot) (1)	\$ 3.71	\$ 2.42	\$ 2.89
Leasing commissions (per rentable square foot) (1)	\$ 1.28	\$ 0.78	\$ 0.96

(1) Weighted average per rentable square foot on an annual basis over the lease term.

Compared to previous leases in the same office spaces, annual combined GAAP rents for new and renewal leases signed in the fourth quarter were \$26.96 per rentable square foot, or 13.9% higher.

We strive to maintain a diverse, stable and creditworthy customer base. We have an internal guideline whereby customers that account for more than 3% of our revenues are periodically reviewed with the Company's Board of Directors. As of December 31, 2016, no customer accounted for more than 3% of our cash revenues other than the Federal Government, which accounted for less than 6% of our cash revenues on an annualized basis. See "Item 2. Properties - Customers."

## **Operating Expenses**

Our expenses primarily consist of rental property expenses, depreciation and amortization, general and administrative expenses and interest expense. From time to time, expenses also include impairments of real estate assets. Rental property expenses are expenses associated with our ownership and operation of rental properties and include expenses that vary somewhat proportionately to occupancy levels, such as janitorial services and utilities, and expenses that do not vary based on occupancy, such as property taxes and insurance. Depreciation and amortization is a non-cash expense associated with the ownership of real property and generally remains relatively consistent each year, unless we buy, place in service or sell assets, since we depreciate our properties and related building and tenant improvement assets on a straight-line basis over fixed lives. General and administrative expenses consist primarily of management and employee salaries and other personnel costs, corporate overhead and short and long-term incentive compensation.

## **Net Operating Income**

Whether or not we record increasing same property net operating income ("NOI") depends upon our ability to garner higher rental revenues, whether from higher average occupancy, higher GAAP rents per rentable square foot or higher cost recovery income, that exceed any corresponding growth in operating expenses. Same property NOI from continuing operations was \$15.0 million, or 4.2%, higher in 2016 as compared to 2015 due to an increase in same property revenues of \$15.7 million offset by an increase of \$0.6 million in same property expenses. We expect same property NOI to be higher in 2017 than 2016 as higher rental revenues, mostly from higher average GAAP rents per rentable square foot and higher cost recovery income, are expected to more than offset a corresponding increase in same property operating expenses.

In addition to the effect of same property NOI, whether or not NOI from continuing operations increases depends upon whether the NOI from our acquired properties and development properties placed in service exceeds the NOI from sold properties. NOI from continuing operations was \$45.8 million, or 11.8%, higher in 2016 as compared to 2015 due to the impact of acquisitions and development properties placed in service, offset by NOI lost from sold properties not classified as discontinued operations. We expect NOI from continuing operations to be higher in 2017 than 2016 due to the impact of our net investment activity in 2016.

## **Cash Flows**

In calculating net cash related to operating activities, depreciation and amortization, which are non-cash expenses, are added back to net income. As a result, we have historically generated a positive amount of cash from operating activities. From period to period, cash flow from operations depends primarily upon changes in our net income, as discussed more fully below under "Results of Operations," changes in receivables and payables and net additions or decreases in our overall portfolio.

Net cash related to investing activities generally relates to capitalized costs incurred for leasing and major building improvements and our acquisition, development, disposition and joint venture activity. During periods of significant net acquisition and/or development activity, our cash used in such investing activities will generally exceed cash provided by investing activities, which typically consists of cash received upon the sale of properties and distributions from our joint ventures.

Net cash related to financing activities generally relates to distributions, incurrence and repayment of debt, and issuances, repurchases or redemptions of Common Stock, Common Units and Preferred Stock. We use a significant amount of our cash to fund distributions. Whether or not we have increases in the outstanding balances of debt during a period depends generally upon the net effect of our acquisition, disposition, development and joint venture activity. We generally use our revolving credit facility for daily working capital purposes, which means that during any given period, in order to minimize interest expense, we may record significant repayments and borrowings under our revolving credit facility.

## **Liquidity and Capital Resources**

We intend to maintain a conservative and flexible balance sheet with access to multiple sources of debt and equity capital and sufficient availability under our revolving credit facility that allows us to capitalize on favorable development and acquisition opportunities as they arise.

Rental and other revenues are our principal source of funds to meet our short-term liquidity requirements. Other sources of funds for short-term liquidity needs include available working capital and borrowings under our revolving credit facility, which had \$426.0 million of availability at January 27, 2017. Our short-term liquidity requirements primarily consist of operating expenses, interest and principal amortization on our debt, distributions and capital expenditures, including building improvement costs, tenant improvement costs and lease commissions. Building improvements are capital costs to maintain or enhance existing buildings not typically related to a specific customer. Tenant improvements are the costs required to customize space for the specific needs of customers. We anticipate that our available cash and cash equivalents and cash provided by operating activities and planned financing activities, including borrowings under our revolving credit facility, will be adequate to meet our short-term liquidity requirements. We use our revolving credit facility for working capital purposes and for the short-term funding of our development and acquisition activity and, in certain instances, the repayment of other debt. The continued ability to borrow under the revolving credit facility allows us to quickly capitalize on strategic opportunities at short-term interest rates.

Our long-term liquidity uses generally consist of the retirement or refinancing of debt upon maturity, funding of building improvements, new building developments and land infrastructure projects and funding acquisitions of buildings and development land. Additionally, we may, from time to time, retire some or all of our remaining outstanding Preferred Stock and/or unsecured debt securities through redemptions, open market repurchases, privately negotiated acquisitions or otherwise.

We expect to meet our long-term liquidity needs through a combination of:

- cash flow from operating activities;
- bank term loans and borrowings under our revolving credit facility;
- the issuance of unsecured debt;
- the issuance of secured debt;
- the issuance of equity securities by the Company or the Operating Partnership; and
- the disposition of non-core assets.

We generally expect to grow our company on a leverage-neutral basis. At December 31, 2016, our leverage ratio, as measured by the ratio of our mortgages and notes payable and outstanding preferred stock to the undepreciated book value of our assets, was 34.7% and there were 104.6 million diluted shares of Common Stock outstanding.

For a discussion regarding dividends and distributions, see "Liquidity and Capital Resources - Dividends and Distributions."

### **Investment Activity**

As noted above, a key tenet of our strategic plan is to continuously upgrade the quality of our office portfolio through acquisitions, dispositions and development. We generally seek to acquire and develop office buildings that improve the average quality of our overall portfolio and deliver consistent and sustainable value for our stockholders over the long-term. Whether or not an asset acquisition or new development results in higher per share net income or funds from operations ("FFO") in any given period depends upon a number of factors, including whether the NOI for any such period exceeds the actual cost of capital used to finance the acquisition or development. Additionally, given the length of construction cycles, development projects are not placed in service until, in some cases, several years after commencement. Sales of non-core assets could result in lower per share net income or FFO in any given period in the event the resulting use of proceeds does not exceed the capitalization rate on the sold properties.

## Results of Operations

### Comparison of 2016 to 2015

#### *Rental and Other Revenues*

Rental and other revenues were \$61.0 million, or 10.1%, higher in 2016 as compared to 2015 primarily due to acquisitions and development properties placed in service and higher same property revenues, which increased rental and other revenues by \$35.6 million, \$15.5 million and \$15.7 million, respectively. Same property rental and other revenues were higher primarily due to an increase in average occupancy to 93.1% in 2016 from 92.3% in 2015, higher average GAAP rents per rentable square foot and higher termination fees. These increases were partly offset by lost revenue of \$5.1 million from property dispositions. We expect rental and other revenues to be higher in 2017 as compared to 2016 due to the full year contribution of acquisitions closed and development properties placed in service in 2016 and higher same property revenues, partly offset by lost revenue from 2016 property dispositions.

#### *Operating Expenses*

Rental property and other expenses were \$15.1 million, or 7.0%, higher in 2016 as compared to 2015 primarily due to acquisitions and development properties placed in service and higher same property operating expenses, which increased operating expenses by \$13.7 million, \$3.5 million and \$0.6 million, respectively. Same property operating expenses were higher primarily due to higher property taxes and repairs and maintenance, partly offset by lower utilities and property insurance. These increases were partly offset by a \$1.8 million decrease in operating expenses from property dispositions. We expect rental property and other expenses to be higher in 2017 as compared to 2016 due to the full year contribution of acquisitions closed and development properties placed in service in 2016 and higher same property operating expenses, partly offset by lower operating expenses due to 2016 property dispositions.

Depreciation and amortization was \$18.2 million, or 9.0%, higher in 2016 as compared to 2015 primarily due to acquisitions and development properties placed in service, partly offset by property dispositions. We expect 2017 depreciation and amortization to increase over 2016 for similar reasons.

General and administrative expenses were \$0.5 million, or 1.4%, higher in 2016 as compared to 2015 primarily due to higher company-wide base salaries, partly offset by lower incentive compensation. We expect 2017 general and administrative expenses to decrease as compared to 2016 primarily due to lower incentive compensation and acquisition costs, partly offset by higher company-wide base salaries and benefits.

#### *Interest Expense*

Interest expense was \$9.4 million, or 10.9%, lower in 2016 as compared to 2015 primarily due to lower average interest rates, lower average debt balances and higher capitalized interest. We expect 2017 interest expense to decrease as compared to 2016 for similar reasons.

#### *Other Income*

Other income was \$0.6 million, or 35.5%, higher in 2016 as compared to 2015 primarily due to losses on debt extinguishment and deferred compensation plan investments in 2015. We expect 2017 other income to decrease as compared to 2016 due to the repayments of mortgages receivable in 2016.

#### *Gains on Disposition of Property and Net Gains on Disposition of Discontinued Operations*

Total gains were \$417.9 million higher in 2016 as compared to 2015 due to the sales of the Plaza assets.

#### *Gain on Disposition of Investment in Unconsolidated Affiliate*

We recorded a gain on disposition of investment in unconsolidated affiliate of \$4.2 million in 2015 due to the sale of our 20.0% interest in SF-HIW Harborview Plaza, LP (“Harborview”) to our partner. We had no such comparable transaction in 2016.

### ***Equity in Earnings of Unconsolidated Affiliates***

Equity in earnings of unconsolidated affiliates was \$0.7 million, or 14.1%, higher in 2016 as compared to 2015 primarily due to our share of the net effect of the disposition activity by certain unconsolidated affiliates in such periods and higher leasing activity in 2016. We expect 2017 equity in earnings of unconsolidated affiliates to decrease as compared to 2016 primarily due to our share of the net effect of the disposition activity by certain unconsolidated affiliates in 2016 and lower anticipated occupancy in 2017.

### ***Income From Discontinued Operations***

Income from discontinued operations was \$11.6 million lower in 2016 as compared to 2015 due to the sales of the Plaza assets on March 1, 2016.

### ***Earnings Per Common Share - Diluted***

Diluted earnings per common share was \$4.30 higher in 2016 as compared to 2015 due to gains from the sales of the Plaza assets and other increases in net income for the reasons discussed above, partly offset by an increase in the weighted average Common Shares outstanding.

### **Comparison of 2015 to 2014**

#### ***Rental and Other Revenues***

Rental and other revenues were \$48.8 million, or 8.8%, higher in 2015 as compared to 2014 primarily due to recent acquisitions, higher same property revenues and development properties placed in service, which increased rental and other revenues by \$25.5 million, \$24.5 million and \$17.2 million, respectively. Same property rental and other revenues were higher primarily due to an increase in average occupancy to 92.3% in 2015 from 90.5% in 2014, higher average GAAP rents per rentable square foot and higher cost recovery income. These increases were partly offset by lost revenue of \$18.0 million from property dispositions.

#### ***Operating Expenses***

Rental property and other expenses were \$10.1 million, or 4.9%, higher in 2015 as compared to 2014 primarily due to recent acquisitions, higher same property operating expenses and development properties placed in service, which increased operating expenses by \$9.6 million, \$5.0 million and \$3.4 million, respectively. Same property operating expenses were higher primarily due to higher property taxes, janitorial and other building-related services and repairs and maintenance, partly offset by lower property insurance and utilities. These increases were partly offset by a \$6.7 million decrease in operating expenses from property dispositions.

Depreciation and amortization was \$21.3 million, or 11.8%, higher in 2015 as compared to 2014 primarily due to recent acquisitions and development properties placed in service, partly offset by property dispositions.

We recorded an impairment of real estate assets of \$0.6 million in 2014 on a building in Greensboro, which resulted from a change in the assumed timing of future disposition and leasing assumptions. We recorded no such impairment in 2015.

General and administrative expenses were \$2.4 million, or 6.8%, higher in 2015 as compared to 2014 primarily due to higher company-wide base salaries and benefits, incentive compensation and acquisition costs.

#### ***Interest Expense***

Interest expense was \$0.9 million, or 1.1%, higher in 2015 as compared to 2014 primarily due to higher average debt balances and financing obligation interest expense, partly offset by higher capitalized interest.

#### ***Other Income***

Other income was \$0.7 million, or 29.0%, lower in 2015 as compared to 2014 primarily due to the repayments of mortgages receivable in 2014 and 2015.



## ***Gains on Disposition of Property and Net Gains on Disposition of Discontinued Operations***

Total gains were \$33.3 million lower in 2015 as compared to 2014 due to the net effect of the disposition activity in such years.

### ***Gain on Disposition of Investment in Unconsolidated Affiliate***

We recorded a gain on disposition of investment in unconsolidated affiliate of \$4.2 million in 2015 due to the sale of our 20.0% interest in Harborview to our partner. We had no comparable transaction in 2014.

### ***Equity in Earnings of Unconsolidated Affiliates***

Equity in earnings of unconsolidated affiliates was \$3.3 million higher in 2015 as compared to 2014 primarily due to our share of gains recognized by certain of our unconsolidated affiliates in 2015, lower interest expense in 2015 and a net impairment of one of our previous investments in 2014. These increases were partly offset by less net operating income in our unconsolidated affiliates as a result of disposition activity.

### ***Income From Discontinued Operations***

Income from discontinued operations was \$2.9 million, or 15.4%, lower in 2015 as compared to 2014 primarily due to lower termination fees in 2015 and severance costs required to be accrued in 2015 due to the closing of our Kansas City division office upon the sale of the Plaza assets.

### ***Earnings Per Common Share - Diluted***

Diluted earnings per common share was \$0.19, or 16.0%, lower in 2015 as compared to 2014 due to a decrease in net income for the reasons discussed above and an increase in the weighted average Common Shares outstanding.

## **Liquidity and Capital Resources**

### **Statements of Cash Flows**

We report and analyze our cash flows based on operating activities, investing activities and financing activities. The following table sets forth the changes in the Company's cash flows (\$ in thousands):

	Year Ended December 31,			2016-2015 Change	2015-2014 Change
	2016	2015	2014		
Net Cash Provided By Operating Activities	\$ 305,805	\$ 288,879	\$ 266,911	\$ 16,926	\$ 21,968
Net Cash Provided By/(Used In) Investing Activities	203,890	(654,157)	(328,178)	858,047	(325,979)
Net Cash Provided By/(Used In) Financing Activities	(465,241)	361,482	59,915	(826,723)	301,567
<b>Total Cash Flows</b>	<b>\$ 44,454</b>	<b>\$ (3,796)</b>	<b>\$ (1,352)</b>	<b>\$ 48,250</b>	<b>\$ (2,444)</b>

### **Comparison of 2016 to 2015**

The increase in net cash provided by operating activities in 2016 as compared to 2015 was primarily due to higher net cash from the operations of acquisitions, development properties placed in service and same properties, partly offset by the timing of cash paid for expenses. We expect net cash related to operating activities to be higher in 2017 as compared to 2016 primarily due to the full year impact of acquisitions closed and development properties placed in service in 2016.

The change in net cash provided by/(used in) investing activities in 2016 as compared to 2015 was primarily due to the net proceeds from the sales of the Plaza assets and lower acquisition activity in 2016, partly offset by higher investments in development in-process and building improvements in 2016, the repayment of an advance from an unconsolidated affiliate in 2015 and higher net investments in mortgages and notes receivable in 2016. We expect uses of cash for investing activities in 2017 to be primarily driven by whether or not we acquire and commence development of additional office buildings in the BBDs of our markets. Additionally, as of December 31, 2016, we have \$165 million left to fund of our previously-announced development activity. We expect these uses of cash for investing activities will be partly offset by proceeds from non-core dispositions in 2017.

The change in net cash provided by/(used in) financing activities in 2016 as compared to 2015 was primarily due to higher net debt repayments in 2016, partly offset by higher proceeds from the issuance of Common Stock in 2016. Assuming the net effect of our acquisition, disposition and development activity in 2017 results in an increase of our assets, we would expect outstanding debt balances to increase. However, because we plan to continue to maintain a flexible and conservative balance sheet with mortgages and notes payable and outstanding preferred stock representing below 43% of the undepreciated book value of our assets, we would also expect higher outstanding balances of Common Stock in such event.

### Comparison of 2015 to 2014

The increase in net cash provided by operating activities in 2015 as compared to 2014 was primarily due to higher net cash from the operations of recent acquisitions and development properties placed in service in 2014 and 2015, partly offset by higher cash paid for operating expenses in 2015.

The increase in net cash used in investing activities in 2015 as compared to 2014 was primarily due to higher acquisition activity and lower net proceeds from disposition of real estate assets in 2015, partly offset by lower development activity and the repayment of an advance from an unconsolidated affiliate in 2015.

The increase in net cash provided by financing activities in 2015 as compared to 2014 was primarily due to higher net debt borrowings and higher proceeds from the issuance of Common Stock in 2015.

### Capitalization

The following table sets forth the Company's capitalization (in thousands, except per share amounts):

	December 31,	
	2016	2015
Mortgages and notes payable, net, at recorded book value	\$ 1,948,047	\$ 2,491,813
Financing obligation (in liabilities held for sale)	\$ —	\$ 7,402
Preferred Stock, at liquidation value	\$ 28,920	\$ 29,050
Common Stock outstanding	101,666	96,092
Common Units outstanding (not owned by the Company)	2,839	2,900
Per share stock price at year end	\$ 51.01	\$ 43.60
Market value of Common Stock and Common Units	\$ 5,330,800	\$ 4,316,051
Total capitalization	\$ 7,307,767	\$ 6,844,316

At December 31, 2016, our mortgages and notes payable and outstanding preferred stock represented 27.1% of our total capitalization and 34.7% of the undepreciated book value of our assets. See also "Executive Summary - Liquidity and Capital Resources."

Our mortgages and notes payable as of December 31, 2016 consisted of \$128.2 million of secured indebtedness with a weighted average interest rate of 4.35% and \$1,826.1 million of unsecured indebtedness with a weighted average interest rate of 3.91%. The secured indebtedness was collateralized by real estate assets with an aggregate undepreciated book value of \$251.9 million. As of December 31, 2016, \$475.0 million of our debt does not bear interest at fixed rates or is not protected by interest rate hedge contracts.

### Investment Activity

During the third quarter of 2016, we acquired a building in the central business district of Raleigh, which delivered in 2015 and encompasses 243,000 rentable square feet, for a net purchase price of \$76.9 million. We expensed \$0.3 million of acquisition costs (included in general and administrative expenses) related to this acquisition. The assets acquired and liabilities assumed were recorded at fair value as determined by management, with the assistance of third party specialists, based on information available at the acquisition date and on current assumptions as to future operations. We have invested or intend to invest an additional \$6.6 million of planned near-term building improvements and leasing capital expenditures to bring the property to stabilization. Based on the total anticipated investment of \$83.5 million, the anticipated capitalization rate for the acquisition of this building, which was 70.0% leased as of the closing date, is 7.2% using projected annual GAAP net operating income upon stabilization, which is

projected to occur in 2018. These forward-looking statements are subject to risks and uncertainties. See "Disclosure Regarding Forward-Looking Statements."

During the third quarter of 2016, we also acquired:

- fee simple title to the land underneath one of our buildings in Pittsburgh that was previously subject to a ground lease for a purchase price of \$18.5 million. We expensed \$0.5 million of acquisition costs (included in general and administrative expenses) related to this acquisition; and
- an acre of development land in Raleigh for a purchase price, including capitalized acquisition costs, of \$5.8 million.

During the second quarter of 2016, we acquired 14 acres of development land in Nashville for a purchase price, including capitalized acquisition costs, of \$9.1 million.

In the normal course of business, we regularly evaluate potential acquisitions. As a result, from time to time, we may have one or more potential acquisitions under consideration that are in varying stages of evaluation, negotiation or due diligence, including potential acquisitions that are subject to non-binding letters of intent or enforceable contracts. Consummation of any transaction is subject to a number of contingencies, including the satisfaction of customary closing conditions. No assurances can be provided that we will acquire any properties in the future. See "Item 1A. Risk Factors - Recent and future acquisitions and development properties may fail to perform in accordance with our expectations and may require renovation and development costs exceeding our estimates."

During the fourth quarter of 2016, we sold land for an aggregate sale price of \$3.7 million and recorded aggregate gains on disposition of property of \$0.6 million.

During the third quarter of 2016, we sold land for a sale price of \$6.8 million and recorded a gain on disposition of property of \$3.9 million. We deferred \$0.4 million of gain related to a portion of the sale price that was escrowed for contingent future infrastructure work.

During the second quarter of 2016, we sold a building for a sale price of \$14.2 million and recorded a gain on disposition of property of \$5.9 million.

During the first quarter of 2016, we sold:

- the Plaza assets for a sale price of \$660.0 million (before closing credits to buyer of \$4.8 million). We recorded gains on disposition of discontinued operations of \$414.5 million and a gain on disposition of property of \$1.3 million related to the land;
- a 32,000 square foot building for a sale price of \$4.7 million (before closing credits to buyer of \$0.1 million) and recorded a gain on disposition of property of \$1.1 million. The buyer, which leased 79% of the building, is a family business controlled by a director of the Company. The sale price exceeded the value set forth in an appraisal performed by a reputable independent commercial real estate services firm that has no relationship with the director or any of his affiliates; and
- a building for a sale price of \$6.4 million (before closing credits to buyer of \$0.5 million) and recorded a gain on disposition of property of \$2.0 million.

As of December 31, 2016, we were also developing 1.2 million rentable square feet of office properties. For a table summarizing our announced and in-process office developments, see "Item 2. Properties - In-Process Development."

## **Financing Activity**

During the first quarter of 2016, we entered into separate equity distribution agreements with each of Jefferies LLC, Robert W. Baird & Co. Incorporated, BB&T Capital Markets, a division of BB&T Securities, LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Capital One Securities, Inc., Comerica Securities, Inc., Mitsubishi UFJ Securities (USA), Inc., Morgan Stanley & Co. LLC, Piper Jaffray & Co., RBC Capital Markets, LLC and Wells Fargo Securities, LLC. Under the terms of the equity distribution agreements, the Company could offer and sell up to \$250.0 million in aggregate gross sales price of shares of Common Stock from time to time through such firms, acting as agents of the Company or as principals. Sales of the shares, if any, may be made by means of ordinary brokers' transactions on the New York Stock Exchange or otherwise at market prices prevailing at the

time of sale, at prices related to prevailing market prices or at negotiated prices or as otherwise agreed with any of such firms. During 2016, the Company issued 5,078,940 shares of Common Stock at an average gross sales price of \$49.22 per share and received net proceeds, after sales commissions, of \$246.2 million. We paid an aggregate of \$3.7 million in sales commissions to RBC Capital Markets, LLC, Morgan Stanley & Co. LLC, Jefferies LLC, Wells Fargo Securities, LLC, Merrill Lynch, Capital One Securities, Inc., Piper Jaffray & Co., BB&T Capital Markets, Comerica Securities, Inc., Robert W. Baird & Co. Incorporated and Mitsubishi UFJ Securities (USA), Inc. during 2016.

During the second quarter of 2016, we prepaid without penalty the remaining \$43.6 million balance on a secured mortgage loan with an effective interest rate of 7.5% that was originally scheduled to mature in August 2016.

During the third and fourth quarters of 2016, we borrowed an aggregate of \$150.0 million under an unsecured term loan that is originally scheduled to mature in January 2022. The interest rate on the term loan at our current credit ratings is LIBOR plus 110 basis points. The interest rate is based on the higher of the publicly announced ratings from Moody's Investors Service or Standard & Poor's Ratings Services. The financial and other covenants under the term loan are similar to our revolving credit facility.

During the first quarter of 2016, we prepaid without penalty the \$350.0 million balance on our unsecured bridge facility that was originally scheduled to mature in March 2016.

During the first quarter of 2016, we obtained \$150.0 million notional amount of forward-starting swaps that effectively lock the underlying 10-year treasury rate at 1.90% with respect to a forecasted debt issuance expected to occur prior to March 15, 2017. The counterparties under the swaps are major financial institutions.

Our \$475.0 million unsecured revolving credit facility is scheduled to mature in January 2018 and includes an accordion feature that allows for an additional \$75.0 million of borrowing capacity subject to additional lender commitments. Assuming no defaults have occurred, we have an option to extend the maturity for two additional six-month periods. The interest rate at our current credit ratings is LIBOR plus 110 basis points and the annual facility fee is 20 basis points. The interest rate and facility fee are based on the higher of the publicly announced ratings from Moody's Investors Service or Standard & Poor's Ratings Services. There were no amounts outstanding under our revolving credit facility at December 31, 2016 and \$48.8 million outstanding at January 27, 2017. At both December 31, 2016 and January 27, 2017, we had \$0.2 million of outstanding letters of credit, which reduces the availability on our revolving credit facility. As a result, the unused capacity of our revolving credit facility at December 31, 2016 and January 27, 2017 was \$474.8 million and \$426.0 million, respectively.

We regularly evaluate the financial condition of the financial institutions that participate in our credit facilities and as counterparties under interest rate swap agreements using publicly available information. Based on this review, we currently expect these financial institutions to perform their obligations under our existing facilities and swap agreements.

For information regarding our interest hedging activities and other market risks associated with our debt financing activities, see "Item 7A. Quantitative and Qualitative Disclosures About Market Risk."

## **Covenant Compliance**

We are currently in compliance with financial covenants and other requirements with respect to our consolidated debt. Although we expect to remain in compliance with these covenants and ratios for at least the next year, depending upon our future operating performance, property and financing transactions and general economic conditions, we cannot assure you that we will continue to be in compliance.

Our revolving credit facility and bank term loans require us to comply with customary operating covenants and various financial requirements. Upon an event of default on the revolving credit facility, the lenders having at least 51.0% of the total commitments under the revolving credit facility can accelerate all borrowings then outstanding, and we could be prohibited from borrowing any further amounts under our revolving credit facility, which would adversely affect our ability to fund our operations. In addition, certain of our unsecured debt agreements contain cross-default provisions giving the unsecured lenders the right to declare a default if we are in default under more than \$25.0 million with respect to other loans in some circumstances.

As of December 31, 2016, the Operating Partnership had the following unsecured notes outstanding (\$ in thousands):

	Face Amount	Carrying Amount	Stated Interest Rate	Effective Interest Rate
Notes due March 2017	\$ 379,685	\$ 379,661	5.850%	5.880%
Notes due April 2018	\$ 200,000	\$ 200,000	7.500%	7.500%
Notes due June 2021	\$ 300,000	\$ 298,072	3.200%	3.363%
Notes due January 2023	\$ 250,000	\$ 248,412	3.625%	3.752%

The indenture that governs these outstanding notes requires us to comply with customary operating covenants and various financial ratios. The trustee or the holders of at least 25.0% in principal amount of any series of notes can accelerate the principal amount of such series upon written notice of a default that remains uncured after 60 days.

We may not be able to repay, refinance or extend any or all of our debt at maturity or upon any acceleration. If any refinancing is done at higher interest rates, the increased interest expense could adversely affect our cash flow and ability to pay distributions. Any such refinancing could also impose tighter financial ratios and other covenants that restrict our ability to take actions that could otherwise be in our best interest, such as funding new development activity, making opportunistic acquisitions, repurchasing our securities or paying distributions.

### Contractual Obligations

The following table sets forth a summary regarding our known contractual obligations, including required interest payments for those items that are interest bearing, at December 31, 2016 (\$ in thousands):

	Amounts due during the years ending December 31,						Thereafter
	Total	2017	2018	2019	2020	2021	
<b>Mortgages and Notes Payable:</b>							
Principal payments (1)	\$ 1,957,031	\$ 507,031	\$ 200,000	\$ 200,000	\$ 350,000	\$ 300,000	\$ 400,000
Interest payments	176,441	58,186	37,718	29,821	25,006	16,069	9,641
<b>Capitalized Lease Obligations</b>	172	110	29	18	15	—	—
<b>Purchase Obligations:</b>							
Lease and contractual commitments and contingent consideration (2)	263,035	236,127	20,315	1,685	3,405	253	1,250
<b>Operating Lease Obligations:</b>							
Operating ground leases	100,938	2,027	2,063	2,100	2,139	2,162	90,447
<b>Total</b>	<b>\$ 2,497,617</b>	<b>\$ 803,481</b>	<b>\$ 260,125</b>	<b>\$ 233,624</b>	<b>\$ 380,565</b>	<b>\$ 318,484</b>	<b>\$ 501,338</b>

(1) Excludes amortization of premiums, discounts, debt issuance costs and/or purchase accounting adjustments.

(2) Amount represents commitments under signed leases and contracts for operating properties, excluding tenant-funded tenant improvements, and contracts for development/redevelopment projects. This includes \$156.6 million of contractual commitments related to our in-process development activity, of which \$132.3 million is scheduled to be funded in 2017. For a description of our development activity, see "Item 2. Properties - In-Process Development." The timing of these lease and contractual commitments may fluctuate.

The interest payments due on mortgages and notes payable are based on the stated rates for the fixed rate debt and on the rates in effect at December 31, 2016 for the variable rate debt. The weighted average interest rate on our fixed (including debt with a variable rate that is effectively fixed by related interest rate swaps) and variable rate debt was 4.63% and 1.77%, respectively, at December 31, 2016. For additional information about our mortgages and notes payable, see Note 6 to our Consolidated Financial Statements. For additional information about purchase obligations and operating lease obligations, see Note 9 to our Consolidated Financial Statements.

### Off Balance Sheet Arrangements

We generally account for our joint venture investments using the equity method. As a result, joint venture investments are not included in our Consolidated Financial Statements, other than as investments in unconsolidated affiliates and equity in earnings of unconsolidated affiliates.

At December 31, 2016, our unconsolidated joint ventures had \$199.6 million of total assets and \$132.1 million of total liabilities, of which \$122.6 million was outstanding mortgage debt. During 2016, our unconsolidated joint ventures had \$31.2 million of aggregate net income. For additional information about our unconsolidated joint venture activity, see Note 4 to our Consolidated Financial Statements.

During the third quarter of 2016, 4600 Madison Associates, LP ("4600 Madison") (a joint venture in which we owned a 12.5% interest) sold a building to an unrelated third party for a sale price of \$32.7 million and recorded a gain on disposition of property of \$21.3 million. As our cost basis was different from the basis reflected at the joint venture level, we recorded \$1.8 million of gain through equity in earnings of unconsolidated affiliates. Simultaneously with the sale, the joint venture used a portion of the proceeds to pay off all \$6.3 million of its debt.

During the first quarter of 2016, Concourse Center Associates, LLC (a joint venture in which we owned a 50.0% interest) sold two buildings and land to an unrelated third party for an aggregate sale price of \$11.0 million and recorded losses on disposition of property of \$0.1 million. As our cost basis was different from the basis reflected at the joint venture level, we recorded \$0.4 million of gains through equity in earnings of unconsolidated affiliates. Simultaneously with the sale, the joint venture repaid all \$6.6 million of its debt.

During the first quarter of 2016, 4600 Madison sold land to an unrelated third party for a sale price of \$3.4 million and recorded a gain on disposition of property of \$1.0 million. We recorded \$0.1 million as our share of this gain through equity in earnings of unconsolidated affiliates. Simultaneously with the sale, the joint venture used all of the proceeds to pay down \$3.4 million of its debt.

## **Dividends and Distributions**

To maintain its qualification as a REIT, the Company must pay dividends to stockholders that are at least 90.0% of its annual REIT taxable income, excluding net capital gains. The partnership agreement requires the Operating Partnership to distribute at least enough cash for the Company to be able to pay such dividends. The Company's REIT taxable income, as determined by the federal tax laws, does not equal its net income under accounting principles generally accepted in the United States of America ("GAAP"). In addition, although capital gains are not required to be distributed to maintain REIT status, capital gains, if any, are subject to federal and state income tax unless such gains are distributed to stockholders.

Cash dividends and distributions reduce the amount of cash that would otherwise be available for other business purposes, including funding debt maturities, reducing debt or future growth initiatives. The amount of future distributions that will be made is at the discretion of the Company's Board of Directors. For a discussion of the factors that will influence decisions of the Board of Directors regarding dividends and distributions, see "Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities."

During each quarter of 2016, the Company declared and paid a regular cash dividend of \$0.425 per share of Common Stock. In addition, the Company paid a special cash dividend of \$0.80 per share of Common Stock on January 10, 2017 to stockholders of record as of December 27, 2016. The principal purpose of the special dividend was to distribute taxable capital gains associated with the sales of the Plaza assets earlier in 2016.

On February 7, 2017, the Company declared a regular cash dividend of \$0.44 per share of Common Stock, which is payable on March 7, 2017 to stockholders of record as of February 17, 2017.

## **Current and Future Cash Needs**

We anticipate that our available cash and cash equivalents, cash flows from operating activities and other expected financing sources, including the issuance of debt securities by the Operating Partnership (some of which debt securities may be hedged to a fixed interest rate pursuant to the forward-starting swaps discussed below), the issuance of secured debt (including the anticipated \$100.0 million fixed-rate loan discussed below), bank term loans (including the anticipated \$50.0 million expansion of an existing term loan), borrowings under our revolving credit facility, the issuance of equity securities by the Company or the Operating Partnership and the disposition of non-core assets, will be adequate to meet our short-term liquidity requirements, including \$379.7 million principal amount of unsecured notes due March 15, 2017 and the \$109.1 million secured loan due November 1, 2017.

We had \$49.5 million of cash and cash equivalents as of December 31, 2016. The unused capacity of our revolving credit facility at December 31, 2016 and January 27, 2017 was \$474.8 million and \$426.0 million, respectively, excluding an accordion feature that allows for an additional \$75.0 million of borrowing capacity subject to additional lender commitments. Also, we have recently demonstrated historical experience with our banking partners to obtain additional bank term loans, such as the \$350.0

million, six-month unsecured bridge facility we obtained in 2015 for the short-term funding of our acquisition activity and \$150.0 million unsecured term loan we obtained in 2016 to repay amounts outstanding under our revolving credit facility.

To limit the risks associated with interest rate changes, during 2016, we obtained \$150.0 million notional amount of forward-starting swaps that expire on March 15, 2017 and effectively lock the underlying 10-year treasury rate at 1.90% with respect to a planned issuance of debt securities by the Operating Partnership.

We expect to obtain an approximate \$100.0 million fixed-rate loan secured by The Pinnacle at Symphony Place in Nashville with a term of at least 10 years. This planned secured loan is expected to close no later than May 1, 2017, which is the date on which we can prepay without penalty the \$109.1 million secured loan that is scheduled to mature on November 1, 2017. The new secured loan is subject to formal lender commitment, definitive documentation and customary conditions; accordingly, we can make no assurance that the new secured loan will be procured on the terms, including the amount to be borrowed, described above, or at all.

We expect to borrow an additional \$50.0 million under the unsecured bank term loan we obtained in 2016 that is scheduled to mature in January 2022. This planned expansion of the term loan, which will bear interest at LIBOR plus 110 basis points based on our current credit ratings, is expected to close no later than March 31, 2017. The term loan expansion is subject to definitive documentation and customary conditions; accordingly, we can make no assurance that the term loan expansion will be procured on the terms, including the amount to be borrowed, described above, or at all.

We have a currently effective automatic shelf registration statement on Form S-3 with the SEC pursuant to which, at any time and from time to time, in one or more offerings on an as-needed basis, the Company may sell an indefinite amount of common stock, preferred stock and depositary shares and the Operating Partnership may sell an indefinite amount of debt securities, subject to our ability to effect offerings on satisfactory terms based on prevailing market conditions.

The Company from time to time enters into equity distribution agreements with a variety of firms pursuant to which the Company may offer and sell shares of common stock from time to time through such firms, acting as agents of the Company or as principals. Sales of the shares, if any, may be made by means of ordinary brokers' transactions on the NYSE or otherwise at market prices prevailing at the time of sale, at prices related to prevailing market prices or at negotiated prices or as otherwise agreed with any of such firms (which may include block trades).

During 2017, we also expect to sell \$50.0 million to \$150.0 million of properties no longer considered to be core assets due to location, age, quality and/or overall strategic fit. We can make no assurance, however, that we will sell any non-core assets or, if we do, what the timing or terms of any such sale will be.

We generally intend to fund the growth of our company, including the \$132.3 million of contractual commitments in 2017 related to our in-process development activity, on a leverage-neutral basis. At December 31, 2016, our leverage ratio was 34.7% and there were 104.6 million diluted shares of Common Stock outstanding.

### **Critical Accounting Estimates**

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. Actual results could differ from our estimates.

The policies used in the preparation of our Consolidated Financial Statements are described in Note 1 to our Consolidated Financial Statements. However, certain of our significant accounting policies contain an increased level of assumptions used or estimates made in determining their impact in our Consolidated Financial Statements. Management has reviewed and determined the appropriateness of our critical accounting policies and estimates with the audit committee of the Company's Board of Directors.

We consider our critical accounting estimates to be those used in the determination of the reported amounts and disclosure related to the following:

- Real estate and related assets;
- Impairments of real estate assets and investments in unconsolidated affiliates;
- Sales of real estate;

- Rental and other revenues; and
- Allowance for doubtful accounts.

### **Real Estate and Related Assets**

Real estate and related assets are recorded at cost and stated at cost less accumulated depreciation. Renovations, replacements and other expenditures that improve or extend the life of assets are capitalized and depreciated over their estimated useful lives. Expenditures for ordinary maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method over the estimated useful life of 40 years for buildings and depreciable land infrastructure costs, 15 years for building improvements and five to seven years for furniture, fixtures and equipment. Tenant improvements are amortized using the straight-line method over initial fixed terms of the respective leases, which generally are from three to 10 years.

Expenditures directly related to the development and construction of real estate assets are included in net real estate assets and are stated at depreciated cost. Development expenditures include pre-construction costs essential to the development of properties, development and construction costs, interest costs on qualifying assets, real estate taxes, development personnel salaries and related costs and other costs incurred during the period of development. Interest and other carrying costs are capitalized until the building is ready for its intended use, but not later than a year from cessation of major construction activity. We consider a construction project as substantially completed and ready for its intended use upon the completion of tenant improvements. We cease capitalization on the portion that is substantially completed and occupied or held available for occupancy, and capitalize only those costs associated with the portion under construction.

Expenditures directly related to the leasing of properties are included in deferred leasing costs and are stated at amortized cost. Such expenditures are part of the investment necessary to execute leases and, therefore, are classified as investment activities in the statement of cash flows. All leasing commissions paid to third parties for new leases or lease renewals are capitalized. Internal leasing costs, which consist primarily of compensation, benefits and other costs, such as legal fees related to leasing activities, that are incurred in connection with successfully obtaining leases of properties are also capitalized. Capitalized leasing costs are amortized on a straight-line basis over the initial fixed terms of the respective leases, which generally are from three to 10 years. Estimated costs related to unsuccessful activities are expensed as incurred.

We record liabilities for the performance of asset retirement activities when the obligation to perform such activities is probable even when uncertainty exists about the timing and/or method of settlement.

Upon the acquisition of real estate assets, we assess the fair value of acquired tangible assets such as land, buildings and tenant improvements, intangible assets and liabilities such as above and below market leases, acquired in-place leases, customer relationships and other identifiable intangible assets and assumed liabilities. We assess fair value based on estimated cash flow projections that utilize discount and/or capitalization rates as well as available market information. The fair value of the tangible assets of an acquired property considers the value of the property as if it were vacant.

The above and below market rate portions of leases acquired in connection with property acquisitions are recorded in deferred leasing costs and in accounts payable, accrued expenses and other liabilities, respectively, at fair value and amortized into rental revenue over the remaining term of the respective leases as described below. Fair value is calculated as the present value of the difference between (1) the contractual amounts to be paid pursuant to each in-place lease and (2) our estimate of fair market lease rates for each corresponding in-place lease, using a discount rate that reflects the risks associated with the leases acquired and measured over a period equal to the remaining initial term of the lease for above-market leases and the remaining initial term plus the term of any renewal option that the customer would be economically compelled to exercise for below-market leases.

In-place leases acquired are recorded at fair value in deferred leasing costs and are amortized to depreciation and amortization expense over the remaining term of the respective lease. The value of in-place leases is based on our evaluation of the specific characteristics of each customer's lease. Factors considered include estimates of carrying costs during hypothetical expected lease-up periods, current market conditions, the customer's credit quality and costs to execute similar leases. In estimating carrying costs, we include real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, depending on local market conditions. In estimating costs to execute similar leases, we consider tenant improvements, leasing commissions and legal and other related expenses.



Real estate and other assets are classified as long-lived assets held for use or as long-lived assets held for sale. Real estate is classified as held for sale when the sale of the asset is probable, has been duly approved by the Company, a legally enforceable contract has been executed and the buyer's due diligence period, if any, has expired.

### **Impairments of Real Estate Assets and Investments in Unconsolidated Affiliates**

With respect to assets classified as held for use, we perform an impairment analysis if events or changes in circumstances indicate that the carrying value may be impaired, such as a significant decline in occupancy, identification of materially adverse legal or environmental factors, change in our designation of an asset from core to non-core, which may impact the anticipated holding period, or a decline in market value to an amount less than cost. This analysis is generally performed at the property level, except when an asset is part of an interdependent group such as an office park, and consists of determining whether the asset's carrying amount will be recovered from its undiscounted estimated future operating and residual cash flows. These cash flows are estimated based on a number of assumptions that are subject to economic and market uncertainties including, among others, demand for space, competition for customers, changes in market rental rates, costs to operate each property and expected ownership periods. For properties under development, the cash flows are based on expected service potential of the asset or asset group when development is substantially complete.

If the carrying amount of a held for use asset exceeds the sum of its undiscounted future operating and residual cash flows, an impairment loss is recorded for the difference between estimated fair value of the asset and the carrying amount. We generally estimate the fair value of assets held for use by using discounted cash flow analyses. In some instances, appraisal information may be available and is used in addition to a discounted cash flow analysis. As the factors used in generating these cash flows are difficult to predict and are subject to future events that may alter our assumptions, the discounted and/or undiscounted future operating and residual cash flows estimated by us in our impairment analyses or those established by appraisal may not be achieved and we may be required to recognize future impairment losses on properties held for use.

We record assets held for sale at the lower of the carrying amount or estimated fair value. Fair value of assets held for sale is equal to the estimated or contracted sales price with a potential buyer, less costs to sell. The impairment loss is the amount by which the carrying amount exceeds the estimated fair value.

We also analyze our investments in unconsolidated affiliates for impairment. This analysis consists of determining whether an expected loss in market value of an investment is other than temporary by evaluating the length of time and the extent to which the market value has been less than cost, the financial condition and near-term prospects of the investment, and our intent and ability to retain our investment for a period of time sufficient to allow for any anticipated recovery in market value. As the factors used in this analysis are difficult to predict and are subject to future events that may alter our assumptions, we may be required to recognize future impairment losses on our investments in unconsolidated affiliates.

### **Sales of Real Estate**

For sales transactions meeting the requirements for full profit recognition, the related assets and liabilities are removed from the balance sheet and the resultant gain or loss is recorded in the period the transaction closes. For sales transactions with continuing involvement after the sale, if the continuing involvement with the property is limited by the terms of the sales contract, profit is recognized at the time of sale and is reduced by the maximum exposure to loss related to the nature of the continuing involvement. Sales to entities in which we have or receive an interest are accounted for using partial sale accounting.

For transactions that do not meet the criteria for a sale, we evaluate the nature of the continuing involvement, including put and call provisions, if present, and account for the transaction as a financing arrangement, profit-sharing arrangement, leasing arrangement or other alternate method of accounting, rather than as a sale, based on the nature and extent of the continuing involvement. Some transactions may have numerous forms of continuing involvement. In those cases, we determine which method is most appropriate based on the substance of the transaction.

### **Rental and Other Revenues**

Minimum contractual rents from leases are recognized on a straight-line basis over the terms of the respective leases. This means that, with respect to a particular lease, actual amounts billed in accordance with the lease during any given period may be higher or lower than the amount of rental revenue recognized for the period. Straight-line rental revenue is commenced when the customer assumes control of the leased premises. Accrued straight-line rents receivable represents the amount by which straight-line rental revenue exceeds rents currently billed in accordance with lease agreements. Contingent rental revenue, such as percentage rent, is accrued when the contingency is removed. Termination fee income is recognized at the later of when the customer has vacated the space or the lease has expired and a fully executed lease termination agreement has been delivered, the amount of the

fee is determinable and collectability of the fee is reasonably assured. Rental revenue reductions related to co-tenancy lease provisions, if any, are accrued when events have occurred that trigger such provisions.

Cost recovery income is determined on a calendar year and a lease-by-lease basis. The most common types of cost recovery income in our leases are common area maintenance (“CAM”) and real estate taxes, for which a customer typically pays its pro-rata share of operating and administrative expenses and real estate taxes in excess of the costs incurred during a contractually specified base year. The computation of cost recovery income is complex and involves numerous judgments, including the interpretation of lease provisions. Leases are not uniform in dealing with such cost recovery income and there are many variations in the computation. Many customers make monthly fixed payments of CAM, real estate taxes and other cost reimbursement items. We accrue income related to these payments each month. We make quarterly accrual adjustments, positive or negative, to cost recovery income to adjust the recorded amounts to our best estimate of the final annual amounts to be billed and collected. After the end of the calendar year, we compute each customer's final cost recovery income and, after considering amounts paid by the customer during the year, issue a bill or credit for the appropriate amount to the customer. The differences between the amounts billed less previously received payments and the accrual adjustment are recorded as increases or decreases to cost recovery income when the final bills are prepared, which occurs during the first half of the subsequent year.

### **Allowance for Doubtful Accounts**

Accounts receivable, accrued straight-line rents receivable and mortgages and notes receivable are reduced by an allowance for amounts that may become uncollectible in the future. We regularly evaluate the adequacy of our allowance for doubtful accounts. The evaluation primarily consists of reviewing past due account balances and considering such factors as the credit quality of our customer, historical trends of the customer and changes in customer payment terms. Additionally, with respect to customers in bankruptcy, we estimate the probable recovery through bankruptcy claims and adjust the allowance for amounts deemed uncollectible. If our assumptions regarding the collectability of receivables prove incorrect, we could experience losses in excess of our allowance for doubtful accounts. The allowance and its related receivable are written-off when we have concluded there is a low probability of collection and we have discontinued collection efforts.

### **Non-GAAP Information**

The Company believes that FFO, FFO available for common stockholders and FFO available for common stockholders per share are beneficial to management and investors and are important indicators of the performance of any equity REIT. Because these FFO calculations exclude such factors as depreciation, amortization and impairments of real estate assets and gains or losses from sales of operating real estate assets, which can vary among owners of identical assets in similar conditions based on historical cost accounting and useful life estimates, they facilitate comparisons of operating performance between periods and between other REITs. Management believes that historical cost accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, management believes the use of FFO, FFO available for common stockholders and FFO available for common stockholders per share, together with the required GAAP presentations, provides a more complete understanding of the Company's performance relative to its competitors and a more informed and appropriate basis on which to make decisions involving operating, financing and investing activities.

FFO, FFO available for common stockholders and FFO available for common stockholders per share are non-GAAP financial measures and therefore do not represent net income or net income per share as defined by GAAP. Net income and net income per share as defined by GAAP are the most relevant measures in determining the Company's operating performance because these FFO measures include adjustments that investors may deem subjective, such as adding back expenses such as depreciation, amortization and impairments. Furthermore, FFO available for common stockholders per share does not depict the amount that accrues directly to the stockholders' benefit. Accordingly, FFO, FFO available for common stockholders and FFO available for common stockholders per share should never be considered as alternatives to net income, net income available for common stockholders, or net income available for common stockholders per share as indicators of the Company's operating performance.

The Company's presentation of FFO is consistent with FFO as defined by NAREIT, which is calculated as follows:

- Net income/(loss) computed in accordance with GAAP;
- Less net income attributable to noncontrolling interests in consolidated affiliates;
- Plus depreciation and amortization of depreciable operating properties;
- Less gains, or plus losses, from sales of depreciable operating properties, plus impairments on depreciable operating properties and excluding items that are classified as extraordinary items under GAAP;

- Plus or minus our share of adjustments, including depreciation and amortization of depreciable operating properties, for unconsolidated joint venture investments (to reflect funds from operations on the same basis); and
- Plus or minus adjustments for depreciation and amortization and gains/(losses) on sales of depreciable operating properties, plus impairments on depreciable operating properties, and noncontrolling interests in consolidated affiliates related to discontinued operations.

In calculating FFO, the Company includes net income attributable to noncontrolling interests in the Operating Partnership, which the Company believes is consistent with standard industry practice for REITs that operate through an UPREIT structure. The Company believes that it is important to present FFO on an as-converted basis since all of the Common Units not owned by the Company are redeemable on a one-for-one basis for shares of its Common Stock.

The following table sets forth the Company's FFO, FFO available for common stockholders and FFO available for common stockholders per share (\$ in thousands, except per share amounts):

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Funds from operations:</b>			
Net income	\$ 541,139	\$ 101,260	\$ 115,972
Net (income) attributable to noncontrolling interests in consolidated affiliates	(1,253)	(1,264)	(1,466)
Depreciation and amortization of real estate assets	217,533	199,449	178,041
Impairments of depreciable properties	—	—	588
(Gains) on disposition of depreciable properties	(8,915)	(9,147)	(37,802)
(Gain) on disposition of investment in unconsolidated affiliate	—	(4,155)	—
Unconsolidated affiliates:			
Depreciation and amortization of real estate assets	2,978	3,203	3,914
Impairment of investment in unconsolidated affiliate	—	—	1,353
(Gains) on disposition of depreciable properties	(2,173)	(946)	(1,194)
Discontinued operations:			
Depreciation and amortization of real estate assets	—	13,820	15,224
(Gains) on disposition of depreciable properties	(414,496)	—	(384)
<b>Funds from operations</b>	<b>334,813</b>	<b>302,220</b>	<b>274,246</b>
Dividends on Preferred Stock	(2,501)	(2,506)	(2,507)
<b>Funds from operations available for common stockholders</b>	<b>\$ 332,312</b>	<b>\$ 299,714</b>	<b>\$ 271,739</b>
<b>Funds from operations available for common stockholders per share</b>	<b>\$ 3.28</b>	<b>\$ 3.08</b>	<b>\$ 2.90</b>
<b>Weighted average shares outstanding (1)</b>	<b>101,398</b>	<b>97,406</b>	<b>93,800</b>

(1) Includes assumed conversion of all potentially dilutive Common Stock equivalents.

In addition, the Company believes NOI from continuing operations and same property NOI are useful supplemental measures of the Company's property operating performance because such metrics provide a performance measure of the revenues and expenses directly involved in owning real estate assets and a perspective not immediately apparent from net income or FFO. The Company defines NOI as rental and other revenues from continuing operations, less rental property and other expenses from continuing operations. The Company defines cash NOI as NOI less lease termination fees, straight-line rent, amortization of lease incentives and amortization of acquired above and below market leases. Other REITs may use different methodologies to calculate NOI and same property NOI.

As of December 31, 2016, our same property portfolio consisted of 217 in-service properties encompassing 26.7 million rentable square feet that were wholly owned during the entirety of the periods presented (from January 1, 2015 to December 31, 2016). As of December 31, 2015, our same property portfolio consisted of 221 in-service properties encompassing 26.2 million rentable square feet that were wholly owned during the entirety of the periods presented (from January 1, 2014 to December 31, 2015). The change in our same property portfolio was due to the addition of three properties encompassing 0.7 million rentable square feet acquired during 2014 and one newly developed property encompassing 0.1 million rentable square feet placed in

service during 2014. These additions were offset by the removal of three properties encompassing 0.2 million rentable square feet that were sold during 2016 and five properties encompassing 0.1 million rentable square feet that are expected to be demolished.

Rental and other revenues related to properties not in our same property portfolio were \$87.0 million and \$41.7 million for the years ended December 31, 2016 and 2015, respectively. Rental property and other expenses related to properties not in our same property portfolio were \$28.1 million and \$13.6 million for the years ended December 31, 2016 and 2015, respectively.

The following table sets forth the Company's NOI and same property NOI:

	<b>Year Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Income from continuing operations before disposition of investment properties and activity in unconsolidated affiliates</b>	\$ 101,946	\$ 64,844
Other income	(2,338)	(1,726)
Interest expense	76,648	86,052
General and administrative expenses	38,153	37,642
Depreciation and amortization	220,140	201,918
<b>Net operating income from continuing operations</b>	434,549	388,730
Less – non same property and other net operating income	(58,913)	(28,130)
<b>Same property net operating income from continuing operations</b>	<u>\$ 375,636</u>	<u>\$ 360,600</u>
Same property net operating income from continuing operations	\$ 375,636	\$ 360,600
Less – lease termination fees, straight-line rent and other non-cash adjustments	(14,098)	(17,073)
<b>Same property cash net operating income from continuing operations</b>	<u>\$ 361,538</u>	<u>\$ 343,527</u>

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The effects of potential changes in interest rates are discussed below. Our market risk discussion includes “forward-looking statements” and represents an estimate of possible changes in fair value or future earnings that would occur assuming hypothetical future movements in interest rates. Actual future results may differ materially from those presented. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources” and the Notes to Consolidated Financial Statements for a description of our accounting policies and other information related to these financial instruments.

We borrow funds at a combination of fixed and variable rates. Borrowings under our revolving credit facility and bank term loans bear interest at variable rates. Our long-term debt, which consists of secured and unsecured long-term financings, typically bears interest at fixed rates. Our interest rate risk management objectives are to limit generally the impact of interest rate changes on earnings and cash flows and lower our overall borrowing costs. To achieve these objectives, from time to time we enter into interest rate hedge contracts such as collars, swaps, caps and treasury lock agreements in order to mitigate our interest rate risk with respect to various debt instruments. We generally do not hold or issue these derivative contracts for trading or speculative purposes.

At December 31, 2016, we had \$1,254.3 million principal amount of fixed rate debt outstanding (not including debt with a variable rate that is effectively fixed by related interest rate hedge contracts). The estimated aggregate fair market value of this debt was \$1,268.6 million. If interest rates had been 100 basis points higher, the aggregate fair market value of our fixed rate debt would have been \$31.5 million lower. If interest rates had been 100 basis points lower, the aggregate fair market value of our fixed rate debt would have been \$33.2 million higher.

At December 31, 2016, we had \$475.0 million of variable rate debt outstanding not protected by interest rate hedge contracts. If the weighted average interest rate on this variable rate debt had been 100 basis points higher, the annual interest expense would increase \$4.8 million. If the weighted average interest rate on this variable rate debt had been 100 basis points lower, the annual interest expense would decrease \$4.8 million.

At December 31, 2016, we had \$225.0 million of variable rate debt outstanding with \$225.0 million of related floating-to-fixed interest rate swaps that effectively fix the underlying LIBOR rate at 1.678%. If the underlying LIBOR interest rates increase or decrease by 100 basis points, the aggregate fair market value of the swaps at December 31, 2016 would increase by \$4.4 million or decrease by \$4.3 million, respectively.

During the first quarter of 2016, we obtained \$150.0 million notional amount of forward-starting swaps that effectively lock the underlying 10-year treasury rate at 1.90% with respect to a forecasted debt issuance expected to occur prior to March 15, 2017. If the underlying treasury rate was to increase or decrease by 100 basis points, the aggregate fair market value of the swaps at December 31, 2016 would increase by \$12.0 million or decrease by \$13.3 million, respectively.

We are exposed to certain losses in the event of nonperformance by the counterparties, which are major financial institutions, under the swaps. We regularly evaluate the financial condition of our counterparties using publicly available information. Based on this review, we currently expect the counterparties to perform fully under the swaps. However, if a counterparty defaults on its obligations under a swap, we could be required to pay the full rates on the applicable debt, even if such rates were in excess of the rate in the contract.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

See page 46 for Index to Consolidated Financial Statements of Highwoods Properties, Inc.

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

## ITEM 9A. CONTROLS AND PROCEDURES

### General

The purpose of this section is to discuss our controls and procedures. The statements in this section represent the conclusions of Edward J. Fritsch, the Company's President and Chief Executive Officer ("CEO"), and Mark F. Mulhern, the Company's Executive Vice President and Chief Financial Officer ("CFO").

The CEO and CFO evaluations of our controls and procedures include a review of the controls' objectives and design, the controls' implementation by us and the effect of the controls on the information generated for use in this Annual Report. We seek to identify data errors, control problems or acts of fraud and confirm that appropriate corrective action, including process improvements, is undertaken. Our controls and procedures are also evaluated on an ongoing basis by or through the following:

- activities undertaken and reports issued by employees responsible for testing our internal control over financial reporting;
- quarterly sub-certifications by representatives from appropriate business and accounting functions to support the CEO's and CFO's evaluations of our controls and procedures;
- other personnel in our finance and accounting organization;
- members of our internal disclosure committee; and
- members of the audit committee of the Company's Board of Directors.

We do not expect that our controls and procedures will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of controls and procedures must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

### Management's Annual Report on the Company's Internal Control Over Financial Reporting

The Company's management is required to establish and maintain internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect transactions and dispositions of assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements.

Under the supervision of the Company's CEO and CFO, we conducted an evaluation of the effectiveness of the Company's internal control over financial reporting at December 31, 2016 based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have concluded that, at December 31, 2016, the Company's internal control over financial reporting was effective. Deloitte & Touche LLP, our independent registered public accounting firm, has issued their attestation report, which is included below, on the effectiveness of the Company's internal control over financial reporting at December 31, 2016.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Highwoods Properties, Inc.  
Raleigh, North Carolina

We have audited the internal control over financial reporting of Highwoods Properties, Inc. and subsidiaries (the “Company”) as of December 31, 2016, based on criteria established in *Internal Control- Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on the Company's Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2016 of the Company and our report dated February 7, 2017 expressed an unqualified opinion on those financial statements and included an explanatory paragraph regarding the Company's adoption of the accounting standard update for reporting discontinued operations.

/s/ Deloitte & Touche LLP

Raleigh, North Carolina  
February 7, 2017

### **Changes in Internal Control Over Financial Reporting**

There were no changes in the Company's internal control over financial reporting during the fourth quarter of 2016 that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### **Disclosure Controls and Procedures**

SEC rules also require us to maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our annual and periodic reports filed with the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. As defined in Rule 13a-15(e) under the Exchange Act, disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us is accumulated and communicated to our management, including the Company's CEO and CFO, to allow for timely decisions regarding required disclosure. The Company's CEO and CFO concluded that the Company's disclosure controls and procedures were effective at the end of the period covered by this Annual Report.

### **ITEM 9B. OTHER INFORMATION**

None.



## **PART III**

### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

Information about the Company's executive officers and directors, the code of ethics that applies to the Company's chief executive officer and senior financial officers, which is posted on our website, and certain corporate governance matters is incorporated herein by reference to the Company's Proxy Statement to be filed in connection with its annual meeting of stockholders to be held on May 10, 2017. No changes have been made to the procedures by which stockholders may recommend nominees to the Company's board of directors since the 2016 annual meeting, which was held on May 11, 2016. See Item X in Part I of this Annual Report for biographical information regarding the Company's executive officers. The Company is the sole general partner of the Operating Partnership.

### **ITEM 11. EXECUTIVE COMPENSATION**

Information about the compensation of the Company's directors and executive officers is incorporated herein by reference to the Company's Proxy Statement to be filed in connection with its annual meeting of stockholders to be held on May 10, 2017.

### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Information about the beneficial ownership of Common Stock and the Company's equity compensation plans is incorporated herein by reference to the Company's Proxy Statement to be filed in connection with its annual meeting of stockholders to be held on May 10, 2017.

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

Information about certain relationships and related transactions and the independence of the Company's directors is incorporated herein by reference to the Company's Proxy Statement to be filed in connection with its annual meeting of stockholders to be held on May 10, 2017.

### **ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Information about fees paid to and services provided by our independent registered public accounting firm is incorporated herein by reference to the Company's Proxy Statement to be filed in connection with its annual meeting of stockholders to be held on May 10, 2017.

## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	<u>Page</u>
<b>Highwoods Properties, Inc.</b>	
Report of Independent Registered Public Accounting Firm	47
Consolidated Financial Statements:	
Consolidated Balance Sheets at December 31, 2016 and 2015	48
Consolidated Statements of Income for the Years Ended December 31, 2016, 2015 and 2014	49
Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2016, 2015 and 2014	50
Consolidated Statements of Equity for the Years Ended December 31, 2016, 2015 and 2014	51
Consolidated Statements of Cash Flows for the Years Ended December 31, 2016, 2015 and 2014	53
Notes to Consolidated Financial Statements	55

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Highwoods Properties, Inc.  
Raleigh, North Carolina

We have audited the accompanying consolidated balance sheets of Highwoods Properties, Inc. and subsidiaries (the “Company”) as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Highwoods Properties, Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for and disclosure of discontinued operations beginning April 1, 2014 due to the adoption of the Financial Accounting Standards Board accounting standard update on reporting discontinued operations and disclosures of disposals of components of an entity.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2016, based on the criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 7, 2017 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

Raleigh, North Carolina  
February 7, 2017

**HIGHWOODS PROPERTIES, INC.**  
**Consolidated Balance Sheets**  
(in thousands, except share and per share data)

	December 31,	
	2016	2015
<b>Assets:</b>		
Real estate assets, at cost:		
Land	\$ 474,375	\$ 443,705
Buildings and tenant improvements	4,313,373	4,063,328
Development in-process	279,602	194,050
Land held for development	77,355	68,244
	<u>5,144,705</u>	<u>4,769,327</u>
Less-accumulated depreciation	(1,134,103)	(1,007,104)
Net real estate assets	4,010,602	3,762,223
Real estate and other assets, net, held for sale	—	240,948
Cash and cash equivalents	49,490	5,036
Restricted cash	29,141	16,769
Accounts receivable, net of allowance of \$624 and \$928, respectively	17,372	29,077
Mortgages and notes receivable, net of allowance of \$105 and \$287, respectively	8,833	2,096
Accrued straight-line rents receivable, net of allowance of \$692 and \$257, respectively	172,829	150,392
Investments in and advances to unconsolidated affiliates	18,846	20,676
Deferred leasing costs, net of accumulated amortization of \$140,081 and \$115,172, respectively	213,500	231,765
Prepaid expenses and other assets, net of accumulated amortization of \$19,904 and \$17,830, respectively	40,437	26,649
Total Assets	<u>\$ 4,561,050</u>	<u>\$ 4,485,631</u>
<b>Liabilities, Noncontrolling Interests in the Operating Partnership and Equity:</b>		
Mortgages and notes payable, net	\$ 1,948,047	\$ 2,491,813
Accounts payable, accrued expenses and other liabilities	313,885	233,988
Liabilities held for sale	—	14,119
Total Liabilities	<u>2,261,932</u>	<u>2,739,920</u>
Commitments and contingencies		
Noncontrolling interests in the Operating Partnership	144,802	126,429
Equity:		
Preferred Stock, \$.01 par value, 50,000,000 authorized shares;		
8.625% Series A Cumulative Redeemable Preferred Shares (liquidation preference \$1,000 per share), 28,920 and 29,050 shares issued and outstanding, respectively	28,920	29,050
Common Stock, \$.01 par value, 200,000,000 authorized shares;		
101,665,554 and 96,091,932 shares issued and outstanding, respectively	1,017	961
Additional paid-in capital	2,850,881	2,598,242
Distributions in excess of net income available for common stockholders	(749,412)	(1,023,135)
Accumulated other comprehensive income/(loss)	4,949	(3,811)
Total Stockholders' Equity	<u>2,136,355</u>	<u>1,601,307</u>
Noncontrolling interests in consolidated affiliates	17,961	17,975
Total Equity	<u>2,154,316</u>	<u>1,619,282</u>
Total Liabilities, Noncontrolling Interests in the Operating Partnership and Equity	<u>\$ 4,561,050</u>	<u>\$ 4,485,631</u>

See accompanying notes to consolidated financial statements.

**HIGHWOODS PROPERTIES, INC.**  
**Consolidated Statements of Income**  
(in thousands, except per share amounts)

	Year Ended December 31,		
	2016	2015	2014
<b>Rental and other revenues</b>	\$ 665,634	\$ 604,671	\$ 555,871
<b>Operating expenses:</b>			
Rental property and other expenses	231,085	215,941	205,884
Depreciation and amortization	220,140	201,918	180,637
Impairments of real estate assets	—	—	588
General and administrative	38,153	37,642	35,258
Total operating expenses	489,378	455,501	422,367
<b>Interest expense:</b>			
Contractual	73,142	82,245	82,287
Amortization of debt issuance costs	3,506	3,645	3,082
Financing obligation	—	162	(242)
	76,648	86,052	85,127
<b>Other income:</b>			
Interest and other income	2,338	1,969	2,739
Losses on debt extinguishment	—	(243)	(308)
	2,338	1,726	2,431
<b>Income from continuing operations before disposition of investment properties and activity in unconsolidated affiliates</b>	101,946	64,844	50,808
Gains on disposition of property	14,807	11,444	44,352
Gain on disposition of investment in unconsolidated affiliate	—	4,155	—
Equity in earnings of unconsolidated affiliates	5,793	5,078	1,827
<b>Income from continuing operations</b>	122,546	85,521	96,987
<b>Discontinued operations:</b>			
Income from discontinued operations	4,097	15,739	18,601
Net gains on disposition of discontinued operations	414,496	—	384
	418,593	15,739	18,985
<b>Net income</b>	541,139	101,260	115,972
Net (income) attributable to noncontrolling interests in the Operating Partnership	(15,596)	(2,918)	(3,542)
Net (income) attributable to noncontrolling interests in consolidated affiliates	(1,253)	(1,264)	(1,466)
Dividends on Preferred Stock	(2,501)	(2,506)	(2,507)
<b>Net income available for common stockholders</b>	\$ 521,789	\$ 94,572	\$ 108,457
<b>Earnings per Common Share – basic:</b>			
Income from continuing operations available for common stockholders	\$ 1.17	\$ 0.84	\$ 1.00
Income from discontinued operations available for common stockholders	4.13	0.16	0.20
Net income available for common stockholders	\$ 5.30	\$ 1.00	\$ 1.20
Weighted average Common Shares outstanding – basic	98,439	94,404	90,743
<b>Earnings per Common Share – diluted:</b>			
Income from continuing operations available for common stockholders	\$ 1.17	\$ 0.84	\$ 0.99
Income from discontinued operations available for common stockholders	4.13	0.16	0.20
Net income available for common stockholders	\$ 5.30	\$ 1.00	\$ 1.19
Weighted average Common Shares outstanding – diluted	101,398	97,406	93,800
<b>Net income available for common stockholders:</b>			
Income from continuing operations available for common stockholders	\$ 115,461	\$ 79,308	\$ 90,069
Income from discontinued operations available for common stockholders	406,328	15,264	18,388
Net income available for common stockholders	\$ 521,789	\$ 94,572	\$ 108,457

See accompanying notes to consolidated financial statements.

**HIGHWOODS PROPERTIES, INC.**  
**Consolidated Statements of Comprehensive Income**  
(in thousands)

	Year Ended December 31,		
	2016	2015	2014
<b>Comprehensive income:</b>			
Net income	\$ 541,139	\$ 101,260	\$ 115,972
Other comprehensive income/(loss):			
Unrealized gains on tax increment financing bond	—	445	584
Unrealized gains/(losses) on cash flow hedges	5,703	(4,040)	(5,662)
Amortization of cash flow hedges	3,057	3,696	3,777
Total other comprehensive income/(loss)	8,760	101	(1,301)
Total comprehensive income	549,899	101,361	114,671
Less-comprehensive (income) attributable to noncontrolling interests	(16,849)	(4,182)	(5,008)
Comprehensive income attributable to common stockholders	<u>\$ 533,050</u>	<u>\$ 97,179</u>	<u>\$ 109,663</u>

See accompanying notes to consolidated financial statements.

**HIGHWOODS PROPERTIES, INC.**  
**Consolidated Statements of Equity**  
(in thousands, except share amounts)

	Number of Common Shares	Common Stock	Series A Cumulative Redeemable Preferred Shares	Additional Paid-In Capital	Accumulated Other Compre- hensive Income/ (Loss)	Non- controlling Interests in Consolidated Affiliates	Distributions in Excess of Net Income Available for Common Stockholders	Total
<b>Balance at December 31, 2013</b>	89,920,915	\$ 899	\$ 29,077	\$ 2,370,368	\$ (2,611)	\$ 21,396	\$ (911,662)	\$ 1,507,467
Issuances of Common Stock, net of issuance costs and tax withholdings	2,812,477	28	—	112,596	—	—	—	112,624
Conversions of Common Units to Common Stock	4,417	—	—	162	—	—	—	162
Dividends on Common Stock	—	—	—	—	—	—	(154,165)	(154,165)
Dividends on Preferred Stock	—	—	—	—	—	—	(2,507)	(2,507)
Adjustment of noncontrolling interests in the Operating Partnership to fair value	—	—	—	(25,275)	—	—	—	(25,275)
Acquisition of noncontrolling interest in consolidated affiliate	—	—	—	(513)	—	(3,613)	—	(4,126)
Distributions to noncontrolling interests in consolidated affiliates	—	—	—	—	—	(1,140)	—	(1,140)
Issuances of restricted stock	169,501	—	—	—	—	—	—	—
Redemptions/repurchases of Preferred Stock	—	—	(17)	—	—	—	—	(17)
Share-based compensation expense, net of forfeitures	—	2	—	6,937	—	—	—	6,939
Net (income) attributable to noncontrolling interests in the Operating Partnership	—	—	—	—	—	—	(3,542)	(3,542)
Net (income) attributable to noncontrolling interests in consolidated affiliates	—	—	—	—	—	1,466	(1,466)	—
Comprehensive income:								
Net income	—	—	—	—	—	—	115,972	115,972
Other comprehensive loss	—	—	—	—	(1,301)	—	—	(1,301)
Total comprehensive income								114,671
<b>Balance at December 31, 2014</b>	92,907,310	929	29,060	2,464,275	(3,912)	18,109	(957,370)	1,551,091
Issuances of Common Stock, net of issuance costs and tax withholdings	3,023,710	30	—	125,507	—	—	—	125,537
Conversions of Common Units to Common Stock	37,203	—	—	1,645	—	—	—	1,645
Dividends on Common Stock	—	—	—	—	—	—	(160,337)	(160,337)
Dividends on Preferred Stock	—	—	—	—	—	—	(2,506)	(2,506)
Adjustment of noncontrolling interests in the Operating Partnership to fair value	—	—	—	(67)	—	—	—	(67)
Distributions to noncontrolling interests in consolidated affiliates	—	—	—	—	—	(1,398)	—	(1,398)
Issuances of restricted stock	128,951	—	—	—	—	—	—	—
Redemptions/repurchases of Preferred Stock	—	—	(10)	—	—	—	—	(10)
Share-based compensation expense, net of forfeitures	(5,242)	2	—	6,882	—	—	—	6,884
Net (income) attributable to noncontrolling interests in the Operating Partnership	—	—	—	—	—	—	(2,918)	(2,918)
Net (income) attributable to noncontrolling interests in consolidated affiliates	—	—	—	—	—	1,264	(1,264)	—
Comprehensive income:								
Net income	—	—	—	—	—	—	101,260	101,260
Other comprehensive income	—	—	—	—	101	—	—	101
Total comprehensive income								101,361
<b>Balance at December 31, 2015</b>	96,091,932	\$ 961	\$ 29,050	\$ 2,598,242	\$ (3,811)	\$ 17,975	\$ (1,023,135)	\$ 1,619,282

**HIGHWOODS PROPERTIES, INC.**  
**Consolidated Statements of Equity - Continued**  
(in thousands, except share amounts)

	Number of Common Shares	Common Stock	Series A Cumulative Redeemable Preferred Shares	Additional Paid-In Capital	Accumulated Other Compre- hensive Income/ (Loss)	Non- controlling Interests in Consolidated Affiliates	Distributions in Excess of Net Income Available for Common Stockholders	Total
<b>Balance at December 31, 2015</b>	96,091,932	\$ 961	\$ 29,050	\$ 2,598,242	\$ (3,811)	\$ 17,975	\$ (1,023,135)	\$ 1,619,282
Issuances of Common Stock, net of issuance costs and tax withholdings	5,390,710	54	—	256,326	—	—	—	256,380
Conversions of Common Units to Common Stock	61,048	—	—	3,057	—	—	—	3,057
Dividends on Common Stock	—	—	—	—	—	—	(166,861)	(166,861)
Special dividend on Common Stock	—	—	—	—	—	—	(81,205)	(81,205)
Dividends on Preferred Stock	—	—	—	—	—	—	(2,501)	(2,501)
Adjustment of noncontrolling interests in the Operating Partnership to fair value	—	—	—	(12,993)	—	—	—	(12,993)
Distributions to noncontrolling interests in consolidated affiliates	—	—	—	—	—	(1,267)	—	(1,267)
Issuances of restricted stock	130,752	—	—	—	—	—	—	—
Redemptions/repurchases of Preferred Stock	—	—	(130)	—	—	—	—	(130)
Share-based compensation expense, net of forfeitures	(8,888)	2	—	6,249	—	—	—	6,251
Net (income) attributable to noncontrolling interests in the Operating Partnership	—	—	—	—	—	—	(15,596)	(15,596)
Net (income) attributable to noncontrolling interests in consolidated affiliates	—	—	—	—	—	1,253	(1,253)	—
Comprehensive income:								
Net income	—	—	—	—	—	—	541,139	541,139
Other comprehensive income	—	—	—	—	8,760	—	—	8,760
<b>Total comprehensive income</b>								<b>549,899</b>
<b>Balance at December 31, 2016</b>	<u>101,665,554</u>	<u>\$ 1,017</u>	<u>\$ 28,920</u>	<u>\$ 2,850,881</u>	<u>\$ 4,949</u>	<u>\$ 17,961</u>	<u>\$ (749,412)</u>	<u>\$ 2,154,316</u>

See accompanying notes to consolidated financial statements.



**HIGHWOODS PROPERTIES, INC.**  
**Consolidated Statements of Cash Flows**  
(in thousands)

	Year Ended December 31,		
	2016	2015	2014
<b>Operating activities:</b>			
Net income	\$ 541,139	\$ 101,260	\$ 115,972
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	220,140	215,957	196,023
Amortization of lease incentives and acquisition-related intangible assets and liabilities	(1,996)	86	442
Share-based compensation expense	6,251	6,884	6,939
Allowance for losses on accounts and accrued straight-line rents receivable	2,001	2,103	2,182
Accrued interest on mortgages and notes receivable	(502)	(357)	(477)
Amortization of debt issuance costs	3,506	3,645	3,082
Amortization of cash flow hedges	3,057	3,696	3,777
Amortization of mortgages and notes payable fair value adjustments	(234)	(58)	(788)
Impairments of real estate assets	—	—	588
Losses on debt extinguishment	—	243	308
Net gains on disposition of property	(429,303)	(11,444)	(44,736)
Gain on disposition of investment in unconsolidated affiliate	—	(4,155)	—
Equity in earnings of unconsolidated affiliates	(5,793)	(5,078)	(1,827)
Changes in financing obligation	—	162	(241)
Distributions of earnings from unconsolidated affiliates	4,424	4,901	2,687
Changes in operating assets and liabilities:			
Accounts receivable	3,401	1,415	(3,114)
Prepaid expenses and other assets	(4,423)	1,266	(615)
Accrued straight-line rents receivable	(24,245)	(22,756)	(21,685)
Accounts payable, accrued expenses and other liabilities	(11,618)	(8,891)	8,394
Net cash provided by operating activities	<u>305,805</u>	<u>288,879</u>	<u>266,911</u>
<b>Investing activities:</b>			
Investments in acquired real estate and related intangible assets, net of cash acquired	(110,249)	(408,634)	(163,641)
Investments in development in-process	(177,875)	(136,664)	(183,873)
Investments in tenant improvements and deferred leasing costs	(91,423)	(115,503)	(113,747)
Investments in building improvements	(80,672)	(55,881)	(50,033)
Investment in acquired noncontrolling interest in consolidated affiliate	—	—	(4,126)
Net proceeds from disposition of real estate assets	684,371	26,748	172,442
Net proceeds from disposition of investment in unconsolidated affiliate	—	6,919	—
Distributions of capital from unconsolidated affiliates	2,766	10,401	3,806
Investments in mortgages and notes receivable	(7,934)	(1,772)	(864)
Repayments of mortgages and notes receivable	1,699	9,381	17,239
Investments in and advances to unconsolidated affiliates	(105)	(659)	(6,489)
Repayments from unconsolidated affiliates	448	20,800	—
Redemption of investment in unconsolidated affiliate	—	—	4,660
Changes in restricted cash and other investing activities	(17,136)	(9,293)	(3,552)
Net cash provided by/(used in) investing activities	<u>\$ 203,890</u>	<u>\$ (654,157)</u>	<u>\$ (328,178)</u>

**HIGHWOODS PROPERTIES, INC.**  
**Consolidated Statements of Cash Flows – Continued**  
(in thousands)

	Year Ended December 31,		
	2016	2015	2014
<b>Financing activities:</b>			
Dividends on Common Stock	\$ (166,861)	\$ (160,337)	\$ (154,165)
Redemptions/repurchases of Preferred Stock	(130)	(10)	(17)
Redemptions of Common Units	—	—	(93)
Dividends on Preferred Stock	(2,501)	(2,506)	(2,507)
Distributions to noncontrolling interests in the Operating Partnership	(4,888)	(4,959)	(4,994)
Distributions to noncontrolling interests in consolidated affiliates	(1,267)	(1,398)	(1,140)
Proceeds from the issuance of Common Stock	264,769	131,341	117,716
Costs paid for the issuance of Common Stock	(3,973)	(2,040)	(1,586)
Repurchase of shares related to tax withholdings	(4,416)	(3,764)	(3,506)
Borrowings on revolving credit facility	287,600	476,300	506,900
Repayments of revolving credit facility	(586,600)	(386,300)	(513,600)
Borrowings on mortgages and notes payable	150,000	475,000	296,949
Repayments of mortgages and notes payable	(395,993)	(156,120)	(174,302)
Payments on financing obligation	—	(1,722)	(2,904)
Payments of debt extinguishment costs	—	—	(369)
Changes in debt issuance costs and other financing activities	(981)	(2,003)	(2,467)
Net cash provided by/(used in) financing activities	(465,241)	361,482	59,915
Net increase/(decrease) in cash and cash equivalents	44,454	(3,796)	(1,352)
Cash and cash equivalents at beginning of the period	5,036	8,832	10,184
Cash and cash equivalents at end of the period	\$ 49,490	\$ 5,036	\$ 8,832

**Supplemental disclosure of cash flow information:**

	Year Ended December 31,		
	2016	2015	2014
Cash paid for interest, net of amounts capitalized	\$ 72,847	\$ 82,242	\$ 83,086

**Supplemental disclosure of non-cash investing and financing activities:**

	Year Ended December 31,		
	2016	2015	2014
Unrealized gains/(losses) on cash flow hedges	\$ 5,703	\$ (4,040)	\$ (5,662)
Conversions of Common Units to Common Stock	3,057	1,645	162
Changes in accrued capital expenditures	8,580	2,547	5,283
Write-off of fully depreciated real estate assets	39,262	48,698	42,633
Write-off of fully amortized debt issuance and leasing costs	26,533	38,264	25,286
Adjustment of noncontrolling interests in the Operating Partnership to fair value	12,993	67	25,275
Unrealized gains on tax increment financing bond	—	445	584
Assumption of mortgages and notes payable related to acquisition activities	—	19,277	—
Contingent consideration in connection with the acquisition of land	—	900	3,300
Special dividend on Common Stock declared	(81,205)	—	—
Special distribution to noncontrolling interests in the Operating Partnership declared	(2,271)	—	—

See accompanying notes to consolidated financial statements.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2016**  
**(tabular dollar amounts in thousands, except per share data)**

**1. Description of Business and Significant Accounting Policies**

**Description of Business**

Highwoods Properties, Inc. (the “Company”) is a fully integrated real estate investment trust (“REIT”) that provides leasing, management, development, construction and other customer-related services for its properties and for third parties. The Company conducts its activities through Highwoods Realty Limited Partnership (the “Operating Partnership”). At December 31, 2016, we owned or had an interest in 31.1 million rentable square feet of in-service properties, 1.1 million rentable square feet of office properties under development and approximately 400 acres of development land.

The Company is the sole general partner of the Operating Partnership. At December 31, 2016, the Company owned all of the Preferred Units and 101.3 million, or 97.3%, of the Common Units in the Operating Partnership. Limited partners owned the remaining 2.8 million Common Units. In the event the Company issues shares of Common Stock, the net proceeds of the issuance are contributed to the Operating Partnership in exchange for additional Common Units. Generally, the Operating Partnership is obligated to redeem each Common Unit at the request of the holder thereof for cash equal to the value of one share of Common Stock based on the average of the market price for the 10 trading days immediately preceding the notice date of such redemption, provided that the Company, at its option, may elect to acquire any such Common Units presented for redemption for cash or one share of Common Stock. The Common Units owned by the Company are not redeemable. During 2016, the Company redeemed 61,048 Common Units for a like number of shares of Common Stock. These redemptions, in conjunction with the proceeds from issuances of Common Stock (see Note 12), increased the percentage of Common Units owned by the Company from 97.1% at December 31, 2015 to 97.3% at December 31, 2016.

**Basis of Presentation**

Our Consolidated Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). Our Consolidated Statements of Income for the year ended December 31, 2014 were retrospectively revised from previously reported amounts to reclassify the operations for those properties classified as discontinued operations.

The Company's Consolidated Financial Statements include the Operating Partnership, wholly owned subsidiaries and those entities in which the Company has the controlling interest. We consolidate joint venture investments, such as interests in partnerships and limited liability companies, when we control the major operating and financial policies of the investment through majority ownership, in our capacity as a general partner or managing member or through some other contractual right. At December 31, 2016, three properties owned through a joint venture investment were consolidated.

In addition, we consolidate those entities deemed to be variable interest entities in which we are determined to be the primary beneficiary. During 2015, we acquired three buildings and a land parcel using special purpose entities owned by qualified intermediaries to facilitate a potential Section 1031 reverse exchange under the Internal Revenue Code. We determined that these entities were variable interest entities of which we were the primary beneficiary; therefore, we consolidated these entities as of December 31, 2015. At such time, these variable interest entities had total assets, liabilities and cash flows of \$421.3 million, \$16.3 million, and \$7.1 million, respectively. During 2016, we subsequently acquired such special purpose entities and therefore own direct title to these buildings.

All intercompany transactions and accounts have been eliminated.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**1. Description of Business and Significant Accounting Policies – Continued**

During 2015, as a result of our partner's irrevocable exercise of a buy-sell provision in our SF-HIW Harborview Plaza, LP ("Harborview") joint venture agreement, our partner's right to put its 80.0% equity interest back to us became no longer exercisable. As a result, we recorded the original contribution transaction as a partial sale. Our investment in this joint venture then qualified for the equity method of accounting, which resulted in the retrospective revision of our Consolidated Balance Sheets and Consolidated Statements of Equity and Capital for prior periods.

**Use of Estimates**

The preparation of consolidated financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the amounts reported in our Consolidated Financial Statements and accompanying notes. Actual results could differ from those estimates.

**Real Estate and Related Assets**

Real estate and related assets are recorded at cost and stated at cost less accumulated depreciation. Renovations, replacements and other expenditures that improve or extend the life of assets are capitalized and depreciated over their estimated useful lives. Expenditures for ordinary maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method over the estimated useful life of 40 years for buildings and depreciable land infrastructure costs, 15 years for building improvements and five to seven years for furniture, fixtures and equipment. Tenant improvements are amortized using the straight-line method over initial fixed terms of the respective leases, which generally are from three to 10 years. Depreciation expense for real estate assets was \$173.1 million, \$168.7 million and \$154.4 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Expenditures directly related to the development and construction of real estate assets are included in net real estate assets and are stated at depreciated cost. Development expenditures include pre-construction costs essential to the development of properties, development and construction costs, interest costs on qualifying assets, real estate taxes, development personnel salaries and related costs and other costs incurred during the period of development. Interest and other carrying costs are capitalized until the building is ready for its intended use, but not later than a year from cessation of major construction activity. We consider a construction project as substantially completed and ready for its intended use upon the completion of tenant improvements. We cease capitalization on the portion that is substantially completed and occupied or held available for occupancy, and capitalize only those costs associated with the portion under construction.

Expenditures directly related to the leasing of properties are included in deferred leasing costs and are stated at amortized cost. Such expenditures are part of the investment necessary to execute leases and, therefore, are classified as investment activities in the statement of cash flows. All leasing commissions paid to third parties for new leases or lease renewals are capitalized. Internal leasing costs, which consist primarily of compensation, benefits and other costs, such as legal fees related to leasing activities, that are incurred in connection with successfully obtaining leases of properties are also capitalized. Capitalized leasing costs are amortized on a straight-line basis over the initial fixed terms of the respective leases, which generally are from three to 10 years. Estimated costs related to unsuccessful activities are expensed as incurred.

We record liabilities for the performance of asset retirement activities when the obligation to perform such activities is probable even when uncertainty exists about the timing and/or method of settlement.

Upon the acquisition of real estate assets, we assess the fair value of acquired tangible assets such as land, buildings and tenant improvements, intangible assets and liabilities such as above and below market leases, acquired in-place leases, customer relationships and other identifiable intangible assets and assumed liabilities. We assess fair value based on estimated cash flow projections that utilize discount and/or capitalization rates as well as available market information. The fair value of the tangible assets of an acquired property considers the value of the property as if it were vacant.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**1. Description of Business and Significant Accounting Policies – Continued**

The above and below market rate portions of leases acquired in connection with property acquisitions are recorded in deferred leasing costs and in accounts payable, accrued expenses and other liabilities, respectively, at fair value and amortized into rental revenue over the remaining term of the respective leases as described below. Fair value is calculated as the present value of the difference between (1) the contractual amounts to be paid pursuant to each in-place lease and (2) our estimate of fair market lease rates for each corresponding in-place lease, using a discount rate that reflects the risks associated with the leases acquired and measured over a period equal to the remaining initial term of the lease for above-market leases and the remaining initial term plus the term of any renewal option that the customer would be economically compelled to exercise for below-market leases.

In-place leases acquired are recorded at fair value in deferred leasing costs and are amortized to depreciation and amortization expense over the remaining term of the respective lease. The value of in-place leases is based on our evaluation of the specific characteristics of each customer's lease. Factors considered include estimates of carrying costs during hypothetical expected lease-up periods, current market conditions, the customer's credit quality and costs to execute similar leases. In estimating carrying costs, we include real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, depending on local market conditions. In estimating costs to execute similar leases, we consider tenant improvements, leasing commissions and legal and other related expenses.

Real estate and other assets are classified as long-lived assets held for use or as long-lived assets held for sale. Real estate is classified as held for sale when the sale of the asset is probable, has been duly approved by the Company, a legally enforceable contract has been executed and the buyer's due diligence period, if any, has expired.

**Impairments of Real Estate Assets and Investments in Unconsolidated Affiliates**

With respect to assets classified as held for use, we perform an impairment analysis if events or changes in circumstances indicate that the carrying value may be impaired, such as a significant decline in occupancy, identification of materially adverse legal or environmental factors, change in our designation of an asset from core to non-core, which may impact the anticipated holding period, or a decline in market value to an amount less than cost. This analysis is generally performed at the property level, except when an asset is part of an interdependent group such as an office park, and consists of determining whether the asset's carrying amount will be recovered from its undiscounted estimated future operating and residual cash flows. These cash flows are estimated based on a number of assumptions that are subject to economic and market uncertainties including, among others, demand for space, competition for customers, changes in market rental rates, costs to operate each property and expected ownership periods. For properties under development, the cash flows are based on expected service potential of the asset or asset group when development is substantially complete.

If the carrying amount of a held for use asset exceeds the sum of its undiscounted future operating and residual cash flows, an impairment loss is recorded for the difference between estimated fair value of the asset and the carrying amount. We generally estimate the fair value of assets held for use by using discounted cash flow analyses. In some instances, appraisal information may be available and is used in addition to a discounted cash flow analysis. As the factors used in generating these cash flows are difficult to predict and are subject to future events that may alter our assumptions, the discounted and/or undiscounted future operating and residual cash flows estimated by us in our impairment analyses or those established by appraisal may not be achieved and we may be required to recognize future impairment losses on properties held for use.

We record assets held for sale at the lower of the carrying amount or estimated fair value. Fair value of assets held for sale is equal to the estimated or contracted sales price with a potential buyer, less costs to sell. The impairment loss is the amount by which the carrying amount exceeds the estimated fair value.

We also analyze our investments in unconsolidated affiliates for impairment. This analysis consists of determining whether an expected loss in market value of an investment is other than temporary by evaluating the length of time and the extent to which the market value has been less than cost, the financial condition and near-term prospects of the investment, and our intent and ability to retain our investment for a period of time sufficient to allow for any anticipated recovery in market value. As the factors used in this analysis are difficult to predict and are subject to future events that may alter our assumptions, we may be required to recognize future impairment losses on our investments in unconsolidated affiliates.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**1. Description of Business and Significant Accounting Policies – Continued**

**Sales of Real Estate**

For sales transactions meeting the requirements for full profit recognition, the related assets and liabilities are removed from the balance sheet and the resultant gain or loss is recorded in the period the transaction closes. For sales transactions with continuing involvement after the sale, if the continuing involvement with the property is limited by the terms of the sales contract, profit is recognized at the time of sale and is reduced by the maximum exposure to loss related to the nature of the continuing involvement. Sales to entities in which we have or receive an interest are accounted for using partial sale accounting.

For transactions that do not meet the criteria for a sale, we evaluate the nature of the continuing involvement, including put and call provisions, if present, and account for the transaction as a financing arrangement, profit-sharing arrangement, leasing arrangement or other alternate method of accounting, rather than as a sale, based on the nature and extent of the continuing involvement. Some transactions may have numerous forms of continuing involvement. In those cases, we determine which method is most appropriate based on the substance of the transaction.

**Rental and Other Revenues**

Minimum contractual rents from leases are recognized on a straight-line basis over the terms of the respective leases. This means that, with respect to a particular lease, actual amounts billed in accordance with the lease during any given period may be higher or lower than the amount of rental revenue recognized for the period. Straight-line rental revenue is commenced when the customer assumes control of the leased premises. Accrued straight-line rents receivable represents the amount by which straight-line rental revenue exceeds rents currently billed in accordance with lease agreements. Contingent rental revenue, such as percentage rent, is accrued when the contingency is removed. Termination fee income is recognized at the later of when the customer has vacated the space or the lease has expired and a fully executed lease termination agreement has been delivered, the amount of the fee is determinable and collectability of the fee is reasonably assured. Rental revenue reductions related to co-tenancy lease provisions, if any, are accrued when events have occurred that trigger such provisions.

Cost recovery income is determined on a calendar year and a lease-by-lease basis. The most common types of cost recovery income in our leases are common area maintenance (“CAM”) and real estate taxes, for which a customer typically pays its pro-rata share of operating and administrative expenses and real estate taxes in excess of the costs incurred during a contractually specified base year. The computation of cost recovery income is complex and involves numerous judgments, including the interpretation of lease provisions. Leases are not uniform in dealing with such cost recovery income and there are many variations in the computation. Many customers make monthly fixed payments of CAM, real estate taxes and other cost reimbursement items. We accrue income related to these payments each month. We make quarterly accrual adjustments, positive or negative, to cost recovery income to adjust the recorded amounts to our best estimate of the final annual amounts to be billed and collected. After the end of the calendar year, we compute each customer's final cost recovery income and, after considering amounts paid by the customer during the year, issue a bill or credit for the appropriate amount to the customer. The differences between the amounts billed less previously received payments and the accrual adjustment are recorded as increases or decreases to cost recovery income when the final bills are prepared, which occurs during the first half of the subsequent year.

**Allowance for Doubtful Accounts**

Accounts receivable, accrued straight-line rents receivable and mortgages and notes receivable are reduced by an allowance for amounts that may become uncollectible in the future. We regularly evaluate the adequacy of our allowance for doubtful accounts. The evaluation primarily consists of reviewing past due account balances and considering such factors as the credit quality of our customer, historical trends of the customer and changes in customer payment terms. Additionally, with respect to customers in bankruptcy, we estimate the probable recovery through bankruptcy claims and adjust the allowance for amounts deemed uncollectible. If our assumptions regarding the collectability of receivables prove incorrect, we could experience losses in excess of our allowance for doubtful accounts. The allowance and its related receivable are written-off when we have concluded there is a low probability of collection and we have discontinued collection efforts.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**1. Description of Business and Significant Accounting Policies – Continued**

**Discontinued Operations**

Properties that are sold or classified as held for sale are classified as discontinued operations provided that the disposal represents a strategic shift that has (or will have) a major effect on our operations and financial results. Interest expense is included in discontinued operations if a related loan securing the sold property is to be paid off or assumed by the buyer in connection with the sale.

**Lease Incentives**

Lease incentive costs, which are payments made to or on behalf of a customer as an incentive to sign a lease, are capitalized in deferred leasing costs and amortized on a straight-line basis over the respective lease terms as a reduction of rental revenues.

**Investments in Unconsolidated Affiliates**

We account for our joint venture investments using the equity method of accounting when our interests represent a general partnership interest but substantive participating rights or substantive kick out rights have been granted to the limited partners or when our interests do not represent a general partnership interest and we do not control the major operating and financial policies of the investment. These investments are initially recorded at cost as investments in unconsolidated affiliates and are subsequently adjusted for our share of earnings and cash contributions and distributions. To the extent our cost basis at formation of the joint venture is different than the basis reflected at the joint venture level, the basis difference is amortized over the life of the related assets and included in our share of equity in earnings of unconsolidated affiliates.

**Cash Equivalents**

We consider highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

**Restricted Cash**

Restricted cash represents cash deposits that are legally restricted or held by third parties on our behalf, such as construction-related escrows, property disposition proceeds set aside and designated or intended to fund future tax-deferred exchanges of qualifying real estate investments, escrows and reserves for debt service, real estate taxes and property insurance established pursuant to certain mortgage financing arrangements and any deposits made with lenders to unencumber secured properties.

**Income Taxes**

The Company has elected and expects to continue to qualify as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the “Code”). A corporate REIT is a legal entity that holds real estate assets and, through the payment of dividends to stockholders, is generally permitted to reduce or avoid the payment of federal and state income taxes at the corporate level. To maintain qualification as a REIT, the Company is required to pay dividends to its stockholders equal to at least 90.0% of its annual REIT taxable income, excluding net capital gains. The partnership agreement requires the Operating Partnership to pay economically equivalent distributions on outstanding Common Units at the same time that the Company pays dividends on its outstanding Common Stock.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**1. Description of Business and Significant Accounting Policies – Continued**

We conduct certain business activities through a taxable REIT subsidiary, as permitted under the Code. The taxable REIT subsidiary is subject to federal, state and local income taxes on its taxable income. We record provisions for income taxes based on its income recognized for financial statement purposes, including the effects of temporary differences between such income and the amount recognized for tax purposes.

**Concentration of Credit Risk**

At December 31, 2016, properties that we wholly own were leased to 1,741 customers. The geographic locations that comprise greater than 10.0% of our rental and other revenues are Raleigh, Atlanta, Tampa and Nashville. Our customers engage in a wide variety of businesses. No single customer generated more than 6% of our consolidated revenues during 2016.

We maintain our cash and cash equivalents and our restricted cash at financial or other intermediary institutions. The combined account balances at each institution may exceed FDIC insurance coverage and, as a result, there is a concentration of credit risk related to amounts on deposit in excess of FDIC insurance coverage. Additionally, from time to time in connection with tax-deferred 1031 transactions, our restricted cash balances may be commingled with other funds being held by any such intermediary institution, which would subject our balance to the credit risk of the institution.

**Derivative Financial Instruments**

We borrow funds at a combination of fixed and variable rates. Borrowings under our revolving credit facility and bank term loans bear interest at variable rates. Our long-term debt typically bears interest at fixed rates. Our interest rate risk management objectives are to limit generally the impact of interest rate changes on earnings and cash flows and lower our overall borrowing costs. To achieve these objectives, from time to time, we enter into interest rate hedge contracts such as collars, swaps, caps and treasury lock agreements in order to mitigate our interest rate risk with respect to various debt instruments. We generally do not hold or issue these derivative contracts for trading or speculative purposes. The interest rate on all of our variable rate debt is generally adjusted at one or three month intervals, subject to settlements under these interest rate hedge contracts.

Interest rate swaps involve the receipt of variable-rate amounts from a counterparty in exchange for making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income/(loss) and is subsequently reclassified into interest expense in the period that the hedged forecasted transaction affects earnings.

We account for terminated derivative instruments by recognizing the related accumulated comprehensive income/(loss) balance in current earnings, unless the hedged forecasted transaction continues as originally planned, in which case we continue to amortize the accumulated comprehensive income/(loss) into earnings over the originally designated hedge period.

**Earnings Per Share**

Basic earnings per share of the Company is computed by dividing net income available for common stockholders by the weighted Common Shares outstanding - basic. Diluted earnings per share is computed by dividing net income available to common stockholders plus noncontrolling interests in the Operating Partnership by the weighted Common Shares outstanding - basic plus the dilutive effect of options, warrants and convertible securities outstanding, including Common Units, using the treasury stock method. Weighted Common Shares outstanding - basic includes all unvested restricted stock where dividends received on such restricted stock are non-forfeitable.



**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**1. Description of Business and Significant Accounting Policies – Continued**

**Recently Issued Accounting Standards**

The Financial Accounting Standards Board (“FASB”) recently issued an accounting standards update (“ASU”) that amended consolidation requirements. The amendments significantly change the consolidation analysis required under GAAP and require companies to reevaluate all previous consolidation conclusions. We adopted the ASU as of January 1, 2016 and there was no impact to consolidated entities included in our Consolidated Financial Statements.

The FASB recently issued an ASU that requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability to which they relate, consistent with debt discounts, as opposed to being presented as assets. For debt issuance costs related to revolving credit facilities, the FASB allows the presentation of debt issuance costs as an asset. We adopted the ASU as of January 1, 2016 with retrospective application to our December 31, 2015 Consolidated Balance Sheets. The effect of the adoption was to reclassify debt issuance costs from deferred financing and leasing costs, net of accumulated amortization, as follows: \$7.8 million to a contra account as a deduction from the related mortgages and notes payable; and \$2.1 million to prepaid expenses and other assets. There was no effect on our Consolidated Statements of Income or Consolidated Statements of Cash Flows.

The FASB recently issued an ASU that requires the use of a new five-step model to recognize revenue from customer contracts. The five-step model requires that we identify the contract with the customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract and recognize revenue when we satisfy the performance obligations. We will also be required to disclose information regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The ASU is required to be adopted in 2018. Retrospective application is required either to all periods presented or with the cumulative effect of initial adoption recognized in the period of adoption. Our initial analysis of our non-lease related revenue contracts indicates that the adoption of this ASU will not have a material effect on our Consolidated Financial Statements; however, we are still in the process of evaluating this ASU.

The FASB recently issued an ASU that adds to and clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows. The ASU is required to be adopted in 2018 with retrospective application required. We do not expect such adoption to have a material effect on our Consolidated Statements of Cash Flows.

The FASB recently issued an ASU which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both lessees and lessors. The ASU requires lessors to account for leases using an approach that is substantially equivalent to the existing guidance and is effective for reporting periods beginning in 2019 with early adoption permitted. We are in the process of evaluating this ASU.

The FASB recently issued an ASU that requires, among other things, the use of a new current expected credit loss (“CECL”) model in determining our allowances for doubtful accounts with respect to accounts receivable, accrued straight-line rents receivable and mortgages and notes receivable. The CECL model requires that we estimate our lifetime expected credit loss with respect to these receivables and record allowances that, when deducted from the balance of the receivables, represent the net amounts expected to be collected. We will also be required to disclose information about how we developed the allowances, including changes in the factors (e.g., portfolio mix, credit trends, unemployment, gross domestic product, etc.) that influenced our estimate of expected credit losses and the reasons for those changes. We will apply the ASU’s provisions as a cumulative-effect adjustment to retained earnings upon adoption in 2020. We are in the process of evaluating this ASU.

The FASB recently issued an ASU that requires management of all entities to evaluate whether there are conditions and events that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the financial statements are issued. We adopted the ASU as of December 31, 2016. We added additional disclosures in Note 6 as a result of the adoption of this ASU.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**2. Real Estate Assets**

**Acquisitions**

During 2016, we acquired a building in Raleigh, which encompasses 243,000 rentable square feet, for a net purchase price of \$76.9 million. We expensed \$0.3 million of acquisition costs (included in general and administrative expenses) related to this acquisition. The assets acquired and liabilities assumed were recorded at fair value as determined by management, with the assistance of third party specialists, based on information available at the acquisition date and on current assumptions as to future operations.

During 2016, we also acquired:

- fee simple title to the land underneath one of our buildings in Pittsburgh that was previously subject to a ground lease for a purchase price of \$18.5 million. We expensed \$0.5 million of acquisition costs (included in general and administrative expenses) related to this acquisition;
- an acre of development land in Raleigh for a purchase price, including capitalized acquisition costs, of \$5.8 million; and
- 14 acres of development land in Nashville for a purchase price, including capitalized acquisition costs, of \$9.1 million.

During 2015, we acquired:

- a building in Tampa encompassing 528,000 rentable square feet for a net purchase price of \$113.5 million and an adjacent land parcel for a purchase price of \$2.2 million;
- two buildings in Atlanta encompassing 896,000 rentable square feet for a net purchase price of \$290.3 million;
- land in Atlanta for a purchase price and related transaction costs of \$5.2 million (including contingent consideration of \$0.9 million); and
- our Highwoods DLF 98/29, LLC joint venture partner's 77.2% interest in a building in Orlando encompassing 168,000 rentable square feet in exchange for the assumption of secured debt recorded at fair value of \$19.3 million (see Note 6).

We expensed \$1.0 million of acquisition costs (included in general and administrative expenses) in 2015 related to these acquisitions. The assets acquired and liabilities assumed were recorded at fair value as determined by management, with the assistance of third party specialists, based on information available at the acquisition date and on current assumptions as to future operations.

The following table sets forth a summary of the fair value of the major assets acquired and liabilities assumed relating to the above-referenced acquisition of two buildings in Atlanta during 2015:

	<b>Total Purchase Price Allocation</b>
Real estate assets	\$ 275,639
Acquisition-related intangible assets (in deferred leasing costs)	23,722
Acquisition-related below market lease liabilities (in accounts payable, accrued expenses and other liabilities)	(9,076)
Total allocation	<u>\$ 290,285</u>

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**2. Real Estate Assets - Continued**

The following table sets forth the Company's revenues and net income, adjusted for interest expense, straight-line rental income, depreciation and amortization related to purchase price allocations and acquisition costs, assuming the above-referenced acquisition of two buildings in Atlanta during 2015 had been completed as of January 1, 2014:

	<b>Year Ended December 31, 2015 (unaudited)</b>
Pro forma revenues	\$ 626,067
Pro forma net income	\$ 103,485
Pro forma net income available for common stockholders	\$ 96,797
Pro forma earnings per share - basic	\$ 1.03
Pro forma earnings per share - diluted	\$ 1.02

The above-referenced acquisition of two buildings in Atlanta during 2015 resulted in revenues of \$7.3 million and net loss of \$1.2 million recorded in the Consolidated Statements of Income for the year ended December 31, 2015.

During 2014, we acquired:

- a building in Orlando encompassing 246,000 rentable square feet for a purchase price of \$67.4 million;
- our partner's 50.0% interest in a building owned by our consolidated Highwoods-Markel Associates, LLC joint venture in Richmond encompassing 66,000 rentable square feet for a purchase price of \$4.2 million, which is recorded as acquisition of noncontrolling interest in consolidated affiliate;
- land in Nashville for a purchase price and related transaction costs of \$15.8 million (including contingent consideration of \$3.3 million); and
- a building in Raleigh encompassing 374,000 rentable square feet for a purchase price of \$83.8 million.

We expensed \$0.5 million of acquisition costs (included in general and administrative expenses) in 2014 related to these acquisitions. The assets acquired and liabilities assumed were recorded at fair value as determined by management, with the assistance of third party specialists, based on information available at the acquisition date and on current assumptions as to future operations.

**Dispositions**

During 2016, we sold:

- substantially all of our wholly-owned Country Club Plaza assets in Kansas City (which we refer to as the "Plaza assets") for a sale price of \$660.0 million (before closing credits to buyer of \$4.8 million). We recorded gains on disposition of discontinued operations of \$414.5 million and a gain on disposition of property of \$1.3 million related to the land; and
- a 32,000 square foot building for a sale price of \$4.7 million (before closing credits to buyer of \$0.1 million) and recorded a gain on disposition of property of \$1.1 million. The buyer, which leased 79% of the building, is a family business controlled by a director of the Company. The sale price exceeded the value set forth in an appraisal performed by a reputable independent commercial real estate services firm that has no relationship with the director or any of his affiliates.

During 2016, we also sold two buildings and various land parcels for an aggregate sale price of \$31.1 million (before closing credits to buyer of \$0.5 million) and recorded aggregate gains on disposition of property of \$12.4 million. We deferred \$0.4 million of gain related to a land sale for a portion of the sale price that was escrowed for contingent future infrastructure work.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**2. Real Estate Assets - Continued**

During 2015, we sold a total of three buildings and various land parcels for an aggregate sale price of \$27.8 million and recorded aggregate gains on disposition of property of \$9.2 million, net of \$0.5 million in taxes payable by our taxable REIT subsidiary.

During 2014, we sold a total of 33 buildings and various land parcels for an aggregate sale price of \$187.3 million (before closing credits to buyer of \$8.6 million for unfunded building and tenant improvements and \$2.9 million for free rent) and recorded aggregate gains on disposition of property of \$44.4 million.

**Impairments**

During 2014, we recorded an impairment of real estate assets of \$0.6 million on a building in Greensboro. This impairment was due to a change in the assumed timing of future disposition and leasing assumptions, which reduced the future expected cash flows from the impaired property.

**3. Mortgages and Notes Receivable**

Mortgages and notes receivable were \$8.8 million and \$2.1 million at December 31, 2016 and 2015, respectively.

During 2010, we provided seller financing in conjunction with two disposition transactions. We accounted for these dispositions using the installment method, whereby a gain on disposition of property was deferred until the seller financing was repaid. During 2014, the \$16.5 million of seller financing was fully repaid and the resultant \$0.4 million gain on disposition of property was recorded.

During 2012, we provided \$8.6 million of secured acquisition financing to a third party. We also agreed to loan such third party \$8.4 million on a secured basis to fund future infrastructure development. During 2015, \$9.9 million of the secured acquisition financing was repaid, including accrued interest. Previously, we concluded this arrangement to be an interest in a variable interest entity. However, since we did not have the power to direct matters that most significantly impact the activities of the entity, we did not qualify as the primary beneficiary. Accordingly, the entity was not consolidated. Our risk of loss with respect to this arrangement was limited to the carrying value of the mortgage receivable.

We evaluate the ability to collect our mortgages and notes receivable by monitoring the leasing statistics and/or market fundamentals of these assets. As of December 31, 2016, our mortgages and notes receivable were not in default and there were no other indicators of impairment.

**4. Investments in and Advances to Affiliates**

**Unconsolidated Affiliates**

We have equity interests of up to 50.0% in various joint ventures with unrelated third parties that are accounted for using the equity method of accounting because we have the ability to exercise significant influence over the operating and financial policies of the joint venture investment.

The following table sets forth our ownership in unconsolidated affiliates at December 31, 2016:

Joint Venture	Location	Ownership Interest
Plaza Colonnade, Tenant-in-Common	Kansas City	50.0%
Highwoods DLF 97/26 DLF 99/32, LP	Orlando	42.9%
Kessinger/Hunter & Company, LC	Kansas City	26.5%
Highwoods DLF Forum, LLC	Raleigh	25.0%
Highwoods DLF 98/29, LLC	Orlando	22.8%

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(tabular dollar amounts in thousands, except per share data)

**4. Investments in and Advances to Affiliates – Continued**

The following table sets forth the summarized balance sheets of our unconsolidated affiliates:

	December 31,	
	2016	2015
<b>Balance Sheets:</b>		
<b>Assets:</b>		
Real estate assets, net	\$ 141,105	\$ 163,852
All other assets, net	58,467	53,511
Total Assets	<u>\$ 199,572</u>	<u>\$ 217,363</u>
<b>Liabilities and Partners' or Stockholders' Equity:</b>		
Mortgages and notes payable, net	\$ 122,560	\$ 141,580
All other liabilities	9,512	6,547
Partners' or stockholders' equity	67,500	69,236
Total Liabilities and Partners' or Stockholders' Equity	<u>\$ 199,572</u>	<u>\$ 217,363</u>
Our share of historical partners' or stockholders' equity	\$ 20,032	\$ 21,022
Advances to unconsolidated affiliates	—	448
Difference between cost of investments and the net book value of underlying net assets	(1,186)	(794)
Carrying value of investments in and advances to unconsolidated affiliates	<u>\$ 18,846</u>	<u>\$ 20,676</u>

The following table sets forth the summarized income statements of our unconsolidated affiliates:

	Year Ended December 31,		
	2016	2015	2014
<b>Income Statements:</b>			
<b>Rental and other revenues</b>	\$ 42,344	\$ 48,118	\$ 50,514
<b>Expenses:</b>			
Rental property and other expenses	17,808	22,721	25,159
Depreciation and amortization	10,348	12,257	13,310
Interest expense	5,191	7,196	8,847
Total expenses	<u>33,347</u>	<u>42,174</u>	<u>47,316</u>
<b>Income before disposition of property</b>	8,997	5,944	3,198
Gains on disposition of property	22,247	18,181	2,998
<b>Net income</b>	<u>\$ 31,244</u>	<u>\$ 24,125</u>	<u>\$ 6,196</u>

The following summarizes additional information related to certain of our unconsolidated affiliates:

**- Concourse Center Associates, LLC ("Concourse")**

During 2016, Concourse (a joint venture in which we owned a 50.0% interest) sold two buildings and land to an unrelated third party for an aggregate sale price of \$11.0 million and recorded losses on disposition of property of \$0.1 million. As our cost basis was different from the basis reflected at the joint venture level, we recorded \$0.4 million of gains through equity in earnings of unconsolidated affiliates. Simultaneously with the sale, the joint venture repaid all \$6.6 million of its debt.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**4. Investments in and Advances to Affiliates – Continued**

**- Highwoods DLF 97/26 DLF 99/32, LP (“DLF II”)**

During 2015, DLF II sold a building to an unrelated third party for a sale price of \$7.0 million and recorded a gain on disposition of property of \$2.1 million. We recorded \$1.1 million as our share of this gain through equity in earnings of unconsolidated affiliates.

**- Kessinger/Hunter & Company, LC (“Kessinger/Hunter”)**

Kessinger/Hunter, which is managed by our joint venture partner, provides leasing services, among other things, to certain buildings that we currently own and/or previously owned in Kansas City in exchange for customary fees from us. Kessinger/Hunter received \$0.4 million, \$0.3 million and \$0.6 million from us for these services in 2016, 2015 and 2014, respectively.

**- Highwoods DLF 98/29, LLC (“DLF I”)**

See Note 2 for a description of our acquisition of a building in Orlando from DLF I during 2015. The joint venture recorded a gain on disposition of property of \$13.7 million. Our share of \$3.1 million was recorded as a reduction to real estate assets.

During 2014, DLF I sold a building to an unrelated third party for a sale price of \$13.7 million (before \$0.4 million in closing credits to buyer for free rent) and recorded a gain on disposition of property of \$1.0 million. We recorded \$0.2 million as our share of this gain through equity in earnings of unconsolidated affiliates.

**- 4600 Madison Associates, LP (“4600 Madison”)**

During 2016, 4600 Madison (a joint venture in which we owned a 12.5% interest) sold a building and land in separate transactions to unrelated third parties for an aggregate sale price of \$36.1 million and recorded gains on disposition of property of \$22.3 million. As our cost basis was different from the basis reflected at the joint venture level, we recorded \$1.9 million of gains through equity in earnings of unconsolidated affiliates. Simultaneously with the sales, the joint venture repaid all \$9.7 million of its debt.

**- Board of Trade Investment Company (“Board of Trade”)**

During 2014, Board of Trade (a joint venture in which we owned a 49.0% interest) sold a building to an unrelated third party for gross proceeds of \$8.3 million and recorded a gain of \$1.9 million. As our cost basis was different from the basis reflected at the entity level, we recorded a net impairment charge on our investment of \$0.4 million. This charge represented the other-than-temporary decline in the fair value below the carrying value of our investment. Our interest in Board of Trade was redeemed in exchange for \$4.7 million in cash.

**- Highwoods KC Glenridge Office, LLC (“KC Glenridge Office”) and Highwoods KC Glenridge Land, LLC (“KC Glenridge Land”)**

During 2015, KC Glenridge Office (a joint venture in which we owned a 40.0% interest) and KC Glenridge Land (a joint venture in which we owned a 39.9% interest) collectively sold two buildings and land to an unrelated third party for an aggregate sale price of \$24.5 million (before closing credits to buyer of \$0.3 million for unfunded tenant improvements) and recorded gains on disposition of property of \$2.4 million. We recorded \$0.9 million as our share of these gains through equity in earnings of unconsolidated affiliates.

During 2014, KC Glenridge Office paid at maturity the remaining \$14.9 million balance on a secured mortgage loan with an effective interest rate of 4.84%.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**4. Investments in and Advances to Affiliates – Continued**

**- Other Activities**

We receive development, management and leasing fees for services provided to certain of our joint ventures. These fees are recognized in income to the extent of our respective joint venture partner's interest. During the years ended December 31, 2016, 2015 and 2014, we recognized \$0.8 million, \$1.4 million and \$1.2 million, respectively, of development/construction, management and leasing fees from our unconsolidated joint ventures. At both December 31, 2016 and 2015, we had receivables of \$0.1 million related to these fees in accounts receivable.

**Consolidated Affiliates**

The following summarizes our consolidated affiliates:

**- Highwoods-Markel Associates, LLC (“Markel”)**

We have a 50.0% ownership interest in Markel. We are the manager and leasing agent for Markel's properties, which are located in Richmond in exchange for customary management and leasing fees. We consolidate Markel since we are the managing member and control the major operating and financial policies of the entity. As controlling member, we have an obligation to cause this property-owning entity to distribute proceeds of liquidation to the noncontrolling interest member in these partially owned properties only if the net proceeds received by the entity from the sale of any of Markel's assets warrant a distribution as determined by the agreement governing the joint venture. We estimate the value of such noncontrolling interest distributions would have been \$24.8 million had the entity been liquidated at December 31, 2016. This estimated settlement value is based on the fair value of the underlying properties which is based on a number of assumptions that are subject to economic and market uncertainties including, among others, demand for space, competition for customers, changes in market rental rates and costs to operate each property. If the entity's underlying assets are worth less than the underlying liabilities on the date of such liquidation, we would have no obligation to remit any consideration to the noncontrolling interest holder.

See Note 2 for a description of our acquisition of the noncontrolling member's 50.0% interest in a building owned by Markel during 2014.

**- Harborview**

We had a 20.0% interest in Harborview, which had been accounted for as a financing obligation since our partner had the right to put its 80.0% equity interest back to us any time prior to September 11, 2015. During 2012, we also provided a three-year \$20.8 million interest-only secured loan to Harborview that was scheduled to mature in September 2015.

During the second quarter of 2015, as a result of our partner's irrevocable exercise of a buy-sell provision in our Harborview joint venture agreement, our partner's right to put its 80.0% equity interest back to us became no longer exercisable, which resulted in recording the original contribution transaction as a partial sale. As a result, we were required to begin accounting for Harborview using the equity method of accounting. See Note 1.

During the third quarter of 2015, we sold our 20.0% interest in Harborview to our partner for net proceeds of \$6.9 million and recorded a \$4.2 million gain on disposition of investment in unconsolidated affiliate. The \$20.8 million interest-only secured loan previously provided by us to Harborview was paid in full upon consummation of the sale.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(tabular dollar amounts in thousands, except per share data)

**5. Intangible Assets and Below Market Lease Liabilities**

The following table sets forth total intangible assets and acquisition-related below market lease liabilities, net of accumulated amortization:

	December 31,	
	2016	2015
<b>Assets:</b>		
Deferred leasing costs (including lease incentives and above market lease and in-place lease acquisition-related intangible assets)	\$ 353,581	\$ 346,937
Less accumulated amortization	(140,081)	(115,172)
	<u>\$ 213,500</u>	<u>\$ 231,765</u>
<b>Liabilities (in accounts payable, accrued expenses and other liabilities):</b>		
Acquisition-related below market lease liabilities	\$ 61,221	\$ 63,830
Less accumulated amortization	(23,074)	(17,927)
	<u>\$ 38,147</u>	<u>\$ 45,903</u>

The following table sets forth amortization of intangible assets and below market lease liabilities:

	Year Ended December 31,		
	2016	2015	2014
Amortization of deferred leasing costs and acquisition-related intangible assets (in depreciation and amortization)	\$ 44,968	\$ 43,332	\$ 38,144
Amortization of lease incentives (in rental and other revenues)	\$ 1,779	\$ 1,493	\$ 1,419
Amortization of acquisition-related intangible assets (in rental and other revenues)	\$ 3,851	\$ 5,062	\$ 4,549
Amortization of acquisition-related intangible assets (in rental property and other expenses)	\$ 557	\$ 557	\$ 557
Amortization of acquisition-related below market lease liabilities (in rental and other revenues)	\$ (8,183)	\$ (7,065)	\$ (6,129)

The following table sets forth scheduled future amortization of intangible assets and below market lease liabilities:

Years Ending December 31,	Amortization of Deferred Leasing Costs and Acquisition-Related Intangible Assets (in Depreciation and Amortization)	Amortization of Lease Incentives (in Rental and Other Revenues)	Amortization of Acquisition-Related Intangible Assets (in Rental and Other Revenues)	Amortization of Acquisition-Related Intangible Assets (in Rental Property and Other Expenses)	Amortization of Acquisition-Related Below Market Lease Liabilities (in Rental and Other Revenues)
2017	\$ 42,508	\$ 1,478	\$ 2,626	\$ 553	\$ (6,231)
2018	34,925	1,374	1,713	553	(5,966)
2019	29,332	1,160	1,322	553	(5,495)
2020	24,727	882	1,002	525	(5,183)
2021	20,510	678	681	—	(4,411)
Thereafter	42,030	2,396	1,972	—	(10,861)
	<u>\$ 194,032</u>	<u>\$ 7,968</u>	<u>\$ 9,316</u>	<u>\$ 2,184</u>	<u>\$ (38,147)</u>
Weighted average remaining amortization periods as of December 31, 2016 (in years)	6.6	7.8	6.4	4.0	7.3



**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**5. Intangible Assets and Below Market Lease Liabilities - Continued**

The following table sets forth the intangible assets acquired and below market lease liabilities assumed as a result of 2016 acquisition activity:

	Acquisition- Related Intangible Assets (amortized in Rental and Other Revenues)	Acquisition- Related Intangible Assets (amortized in Depreciation and Amortization)	Acquisition- Related Below Market Lease Liabilities (amortized in Rental and Other Revenues)
Amount recorded at acquisition	\$ 122	\$ 5,008	\$ (428)
Weighted average remaining amortization periods as of December 31, 2016 (in years)	9.5	9.9	10.9

**6. Mortgages and Notes Payable**

Our mortgages and notes payable consist of the following:

	December 31,	
	2016	2015
<b>Secured indebtedness: (1)</b>		
7.50% mortgage loan due 2016 (2)	\$ —	\$ 43,852
5.10% (4.22% effective rate) mortgage loan due 2017 (3)	109,138	112,230
6.11% (5.36% effective rate) mortgage loan due 2017 (4)	19,066	19,199
	<u>128,204</u>	<u>175,281</u>
<b>Unsecured indebtedness:</b>		
5.85% (5.88% effective rate) notes due 2017 (5)	379,661	379,544
7.50% notes due 2018	200,000	200,000
3.20% (3.363% effective rate) notes due 2021 (6)	298,072	297,639
3.625% (3.752% effective rate) notes due 2023 (7)	248,412	248,150
Variable rate term loan due 2019 (8)	200,000	200,000
Variable rate term loan due 2020 (9)	350,000	350,000
Variable rate term loan due 2022 (10)	150,000	—
Bridge credit facility due 2016 (2)	—	350,000
Revolving credit facility due 2018 (11)	—	299,000
	<u>1,826,145</u>	<u>2,324,333</u>
Less-unamortized debt issuance costs	(6,302)	(7,801)
<b>Total mortgages and notes payable, net</b>	<u>\$ 1,948,047</u>	<u>\$ 2,491,813</u>

(1) Our secured mortgage loans were collateralized by real estate assets with an aggregate undepreciated book value of \$251.9 million at December 31, 2016. Our fixed rate mortgage loans generally are either locked out to prepayment for all or a portion of their term or are prepayable subject to certain conditions including prepayment penalties.

(2) This debt was repaid in 2016.

(3) Net of unamortized fair market value premium of \$0.8 million and \$1.7 million as of December 31, 2016 and 2015, respectively.

(4) Net of unamortized fair market value premium of \$0.1 million and \$0.2 million as of December 31, 2016 and 2015, respectively.

(5) Net of unamortized original issuance discount of less than \$0.1 million and \$0.1 million as of December 31, 2016 and 2015, respectively.

(6) Net of unamortized original issuance discount of \$1.9 million and \$2.4 million as of December 31, 2016 and 2015, respectively.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**6. Mortgages and Notes Payable - Continued**

- (7) Net of unamortized original issuance discount of \$1.6 million and \$1.9 million as of December 31, 2016 and 2015, respectively.
- (8) The interest rate was 1.82% at December 31, 2016.
- (9) As more fully described in Note 7, we entered into floating-to-fixed interest rate swaps that effectively fix LIBOR for the original \$225.0 million portion of this loan. Accordingly, the equivalent fixed rate of this amount is 2.78%. The interest rate on the remaining \$125.0 million was 1.77% at December 31, 2016.
- (10) The interest rate was 1.72% at December 31, 2016.
- (11) There were no amounts outstanding on the revolving credit facility at December 31, 2016.

The following table sets forth scheduled future principal payments, including amortization, due on our mortgages and notes payable at December 31, 2016:

Years Ending December 31,	Principal Amount
2017	\$ 507,170
2018	199,305
2019	199,305
2020	349,305
2021	299,538
Thereafter	399,726
Less-unamortized debt issuance costs	(6,302)
	<u>\$ 1,948,047</u>

Our \$475.0 million unsecured revolving credit facility is scheduled to mature in January 2018 and includes an accordion feature that allows for an additional \$75.0 million of borrowing capacity subject to additional lender commitments. Assuming no defaults have occurred, we have an option to extend the maturity for two additional six-month periods. The interest rate at our current credit ratings is LIBOR plus 110 basis points and the annual facility fee is 20 basis points. There were no amounts outstanding under our revolving credit facility at December 31, 2016 and \$48.8 million outstanding at January 27, 2017. At both December 31, 2016 and January 27, 2017, we had \$0.2 million of outstanding letters of credit, which reduces the availability on our revolving credit facility. As a result, the unused capacity of our revolving credit facility at December 31, 2016 and January 27, 2017 was \$474.8 million and \$426.0 million, respectively.

During 2016, we prepaid without penalty the remaining \$43.6 million balance on a secured mortgage loan with an effective interest rate of 7.5% that was originally scheduled to mature in August 2016. Real estate assets having a gross book value of approximately \$73 million became unencumbered in connection with the payoff of this secured loan. We also paid down \$2.4 million of secured loan balances through principal amortization during 2016.

During 2016, we borrowed an aggregate of \$150.0 million under an unsecured bank term loan that is originally scheduled to mature in January 2022. The interest rate on the term loan at our current credit ratings is LIBOR plus 110 basis points.

During 2015, we prepaid without penalty a secured mortgage loan with a fair market value of \$5.9 million with an effective interest rate of 7.65% that was originally scheduled to mature in February 2016, the remaining \$106.0 million balance on a secured mortgage loan with an effective interest rate of 6.88% that was originally scheduled to mature in January 2016 and the remaining \$39.4 million balance on a secured mortgage loan with an effective interest rate of 6.43% that was originally scheduled to mature in November 2015. We recorded aggregate losses on debt extinguishment of \$0.2 million related to these prepayments.

During 2015, we obtained a \$350.0 million, six-month unsecured bridge facility. The interest rate on the bridge facility at our current credit ratings was LIBOR plus 110 basis points. There was \$350.0 million outstanding under our bridge facility at December 31, 2015. During 2016, we prepaid without penalty the full balance on this unsecured bridge facility.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**6. Mortgages and Notes Payable - Continued**

During 2015, we amended our \$225.0 million, seven-year unsecured bank term loan, which was scheduled to mature in January 2019. We increased the borrowed amount to \$350.0 million. The amended term loan is now scheduled to mature in June 2020 and the interest rate, based on our current credit ratings, was reduced from LIBOR plus 175 basis points to LIBOR plus 110 basis points. We incurred \$1.3 million of debt issuance costs in connection with this amendment, which will be amortized along with existing unamortized debt issuance costs over the remaining term of the new loan.

During 2015, we acquired our joint venture partner's 77.2% interest in a building in Orlando. Simultaneously with this acquisition, the joint venture's previously existing mortgage note was restructured into a new \$18.0 million first mortgage note and a \$10.2 million subordinated note, both of which are scheduled to mature in July 2017. Assuming no defaults have occurred, we have an option to extend the maturity for an additional year. The first mortgage note is interest only with an effective interest rate of 5.36%, payable monthly. The subordinated note has an effective interest rate of 8.6%. Additionally, we deposited \$3.0 million into escrow to fund tenant improvements, leasing commissions and building improvements. The first mortgage note and subordinated note can now be prepaid at any time upon a sale or refinancing of the property. In such event, the subordinated note and any and all accrued interest thereon would be deemed fully satisfied upon payment of a "waterfall payment," if any. Such "waterfall payment" would be a cash payment equal to 50.0% of the amount, if any, by which the net sale proceeds or appraised value in the event of a refinancing exceeds (1) the outstanding principal of the first mortgage note, (2) the funds deposited by us into escrow to fund tenant improvements, leasing commissions and building improvements and (3) a 10.0% return on such funds deposited by us into escrow. As of the date of such restructuring, the fair value of the first mortgage note was \$18.3 million and the fair value of the subordinated note equaled the projected waterfall payment of \$1.0 million.

During 2014, the Operating Partnership issued \$300 million aggregate principal amount of 3.20% Notes due June 15, 2021, less original issue discount of \$3.1 million. These notes were priced at 98.983% for an effective yield of 3.363%. Underwriting fees and other expenses were incurred that aggregated \$2.4 million; these costs were deferred and will be amortized over the term of the notes.

During 2014, we prepaid the remaining \$36.9 million balance on a secured mortgage loan with an effective interest rate of 3.34% that was originally scheduled to mature in April 2015. We recorded \$0.3 million of loss on debt extinguishment related to this prepayment. We also prepaid without penalty the remaining \$123.7 million balance on a secured mortgage loan with an effective interest rate of 3.11% that was originally scheduled to mature in July 2014 and the remaining \$7.2 million balance on a secured mortgage loan with an effective interest rate of 3.32% that was originally scheduled to mature in August 2014. We recorded less than \$0.1 million of gain on debt extinguishment related to this last prepayment.

We are currently in compliance with financial covenants and other requirements with respect to our consolidated debt.

Our revolving credit facility and bank term loans require us to comply with customary operating covenants and various financial requirements. Upon an event of default on the revolving credit facility, the lenders having at least 51.0% of the total commitments under the revolving credit facility can accelerate all borrowings then outstanding, and we could be prohibited from borrowing any further amounts under our revolving credit facility, which would adversely affect our ability to fund our operations. In addition, certain of our unsecured debt agreements contain cross-default provisions giving the unsecured lenders the right to declare a default if we are in default under more than \$25.0 million with respect to other loans in some circumstances.

The Operating Partnership has \$379.7 million carrying amount of 2017 notes outstanding, \$200.0 million carrying amount of 2018 notes outstanding, \$298.1 million carrying amount of 2021 notes outstanding and \$248.4 million carrying amount of 2023 notes outstanding. The indenture that governs these outstanding notes requires us to comply with customary operating covenants and various financial ratios. The trustee or the holders of at least 25.0% in principal amount of any series of notes can accelerate the principal amount of such series upon written notice of a default that remains uncured after 60 days.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**6. Mortgages and Notes Payable - Continued**

We have considered our short-term (one year or less) liquidity needs and the adequacy of our estimated cash flows from operating activities and other expected financing sources to meet these needs. In particular, we have considered our scheduled debt maturities in 2017, including \$379.7 million principal amount of unsecured notes due March 15, 2017 and the \$109.1 million secured loan due November 1, 2017. We expect to meet these short-term liquidity requirements, including the repayment of such unsecured notes and secured loan, through a combination of the following:

- available cash and cash equivalents;
- cash flows from operating activities;
- issuance of debt securities by the Operating Partnership (some of which debt securities may be hedged to a fixed interest rate pursuant to the forward-starting swaps discussed below);
- issuance of secured debt (including the anticipated \$100.0 million fixed-rate loan discussed below);
- bank term loans (including the anticipated \$50.0 million expansion of an existing term loan);
- borrowings under our revolving credit facility;
- issuance of other secured debt;
- issuance of equity securities by the Company or the Operating Partnership; and
- the disposition of non-core assets.

To limit the risks associated with interest rate changes, during 2016, we obtained \$150.0 million notional amount of forward-starting swaps that expire on March 15, 2017 and effectively lock the underlying 10-year treasury rate at 1.90% with respect to a planned issuance of debt securities by the Operating Partnership.

We expect to obtain an approximate \$100.0 million fixed-rate secured loan with a term of at least 10 years. This planned secured loan is expected to close no later than May 1, 2017, which is the date on which we can prepay without penalty the \$109.1 million secured loan that is scheduled to mature on November 1, 2017. The new secured loan is subject to formal lender commitment, definitive documentation and customary conditions.

We expect to borrow an additional \$50.0 million under the unsecured bank term loan we obtained in 2016 that is scheduled to mature in January 2022. This planned expansion of the term loan, which will bear interest at LIBOR plus 110 basis points based on our current credit ratings, is expected to close no later than March 31, 2017. The term loan expansion is subject to definitive documentation and customary conditions.

**Capitalized Interest**

Total interest capitalized to development and significant building and tenant improvement projects was \$8.2 million, \$6.9 million and \$5.3 million for the years ended December 31, 2016, 2015 and 2014, respectively.

**7. Derivative Financial Instruments**

During 2016, we obtained \$150.0 million notional amount of forward-starting swaps that effectively lock the underlying 10-year treasury rate at 1.90% with respect to a forecasted debt issuance expected to occur prior to March 15, 2017.

We also have six floating-to-fixed interest rate swaps through January 2019 each with respect to an aggregate of \$225.0 million LIBOR-based borrowings. These swaps effectively fix the underlying LIBOR rate at a weighted average of 1.678%. The swap agreements contain a provision whereby if we default on more than \$25.0 million of indebtedness and which default results in repayment of such indebtedness being, or becoming capable of being, accelerated by the lender, then we could also be declared in default on our swaps.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**7. Derivative Financial Instruments - Continued**

The counterparties under these swaps are major financial institutions. Our interest rate swaps have been designated as and are being accounted for as cash flow hedges with changes in fair value recorded in other comprehensive income/(loss) each reporting period. No gain or loss was recognized related to hedge ineffectiveness or to amounts excluded from effectiveness testing on our cash flow hedges during the years ended December 31, 2016 and 2015. We have no collateral requirements related to our interest rate swaps.

Amounts reported in accumulated other comprehensive income/(loss) related to derivatives will be reclassified to interest expense as interest payments are made on our variable rate debt. During 2017, we estimate that \$2.3 million will be reclassified to interest expense.

The following table sets forth the gross fair value of our derivatives:

	December 31,	
	2016	2015
<b>Derivatives:</b>		
<b>Derivatives designated as cash flow hedges in prepaid expenses and other assets:</b>		
Interest rate swaps	\$ 7,619	\$ —
<b>Derivatives designated as cash flow hedges in accounts payable, accrued expenses and other liabilities:</b>		
Interest rate swaps	\$ 1,870	\$ 3,073

The following table sets forth the effect of our cash flow hedges on accumulated other comprehensive income/(loss) and interest expense:

	Year Ended December 31,		
	2016	2015	2014
<b>Derivatives Designated as Cash Flow Hedges:</b>			
<b>Amount of unrealized gains/(losses) recognized in accumulated other comprehensive income/(loss) on derivatives (effective portion):</b>			
Interest rate swaps	\$ 5,703	\$ (4,040)	\$ (5,662)
<b>Amount of losses reclassified out of accumulated other comprehensive income/(loss) into contractual interest expense (effective portion):</b>			
Interest rate swaps	\$ 3,057	\$ 3,696	\$ 3,777

**8. Financing Arrangement**

In connection with tax increment financing for a parking garage we constructed in 1999, we were obligated to pay fixed special assessments over a 20-year period ending in 2019. The net present value of these assessments, discounted at the 6.93% interest rate on the underlying tax increment financing, was recorded as a financing obligation and \$7.4 million was classified in liabilities held for sale on our Consolidated Balance Sheets at December 31, 2015. For additional information about this tax increment financing bond, see Notes 11 and 16.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**9. Commitments and Contingencies**

**Operating Ground Leases**

Certain of our properties are subject to operating ground leases. Rental payments on these leases are adjusted periodically based on either the consumer price index or on a pre-determined schedule. Total rental property expense recorded for operating ground leases was \$2.9 million, \$3.4 million and \$3.4 million for the years ended December 31, 2016, 2015 and 2014, respectively.

The following table sets forth our scheduled obligations for future minimum payments on operating ground leases at December 31, 2016:

Years Ending December 31,	Minimum Payments
2017	\$ 2,027
2018	2,063
2019	2,100
2020	2,139
2021	2,162
Thereafter	90,447
	<u>\$ 100,938</u>

**Lease and Contractual Commitments**

We have \$263.0 million of lease and contractual commitments at December 31, 2016. Lease and contractual commitments represent commitments under signed leases and contracts for operating properties (excluding tenant-funded tenant improvements) and contracts for development/redevelopment projects, of which \$73.6 million was recorded on our Consolidated Balance Sheets at December 31, 2016.

**Contingent Consideration**

In 2015, we acquired development land in Atlanta for a purchase price and related transaction costs of \$5.2 million, which includes contingent consideration estimated to be \$0.9 million. The contingent consideration is payable in cash to a third party 30 days subsequent to stabilization, which is projected to be in the second quarter of 2019, if and to the extent the stabilized value of the building constructed on the development site exceeds the total development cost.

In 2014, we acquired development land in Nashville for a purchase price and related transaction costs of \$15.8 million, which includes contingent consideration estimated to be \$3.3 million. The contingent consideration is payable in cash to a third party no later than the first quarter of 2020 if and to the extent the stabilized value of the building constructed on the development site exceeds the total development cost.

**Environmental Matters**

Substantially all of our in-service and development properties have been subjected to Phase I environmental assessments and, in certain instances, Phase II environmental assessments. Such assessments and/or updates have not revealed, nor are we aware of, any environmental liability that we believe would have a material adverse effect on our Consolidated Financial Statements.

**Litigation, Claims and Assessments**

We are from time to time a party to a variety of legal proceedings, claims and assessments arising in the ordinary course of our business. We regularly assess the liabilities and contingencies in connection with these matters based on the latest information available. For those matters where it is probable that we have incurred or will incur a loss and the loss or range of loss can be reasonably estimated, the estimated loss is accrued and charged to income in our Consolidated Financial Statements. In other instances, because of the uncertainties related to both the probable outcome and amount or range of loss, a reasonable estimate of liability, if any, cannot be made. Based on the current expected outcome of such matters, none of these proceedings, claims or assessments is expected to have a material effect on our business, financial condition, results of operations or cash flows.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**10. Noncontrolling Interests**

**Noncontrolling Interests in Consolidated Affiliates**

At December 31, 2016, our noncontrolling interests in consolidated affiliates relate to our joint venture partner's 50.0% interest in office properties in Richmond. Our joint venture partner is an unrelated third party.

**Noncontrolling Interests in the Operating Partnership**

Noncontrolling interests in the Operating Partnership relate to the ownership of Redeemable Common Units. Net income attributable to noncontrolling interests in the Operating Partnership is computed by applying the weighted average percentage of Redeemable Common Units during the period, as a percent of the total number of outstanding Common Units, to the Operating Partnership's net income for the period after deducting distributions on Preferred Units. When a noncontrolling unitholder redeems a Common Unit for a share of Common Stock or cash, the noncontrolling interests in the Operating Partnership are reduced and the Company's share in the Operating Partnership is increased by the fair value of each security at the time of redemption.

The following table sets forth the Company's noncontrolling interests in the Operating Partnership:

	Year Ended December 31,	
	2016	2015
Beginning noncontrolling interests in the Operating Partnership	\$ 126,429	\$ 130,048
Adjustment of noncontrolling interests in the Operating Partnership to fair value	12,993	67
Conversions of Common Units to Common Stock	(3,057)	(1,645)
Net income attributable to noncontrolling interests in the Operating Partnership	15,596	2,918
Distributions to noncontrolling interests in the Operating Partnership	(7,159)	(4,959)
Total noncontrolling interests in the Operating Partnership	<u>\$ 144,802</u>	<u>\$ 126,429</u>

The following table sets forth net income available for common stockholders and transfers from the Company's noncontrolling interests in the Operating Partnership:

	Year Ended December 31,		
	2016	2015	2014
Net income available for common stockholders	\$ 521,789	\$ 94,572	\$ 108,457
Increase in additional paid in capital from conversions of Common Units to Common Stock	3,057	1,645	162
Change from net income available for common stockholders and transfers from noncontrolling interests	<u>\$ 524,846</u>	<u>\$ 96,217</u>	<u>\$ 108,619</u>

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**11. Disclosure About Fair Value of Financial Instruments**

The following summarizes the three levels of inputs that we use to measure fair value.

**Level 1.** Quoted prices in active markets for identical assets or liabilities.

Our Level 1 asset is our investment in marketable securities that we use to pay benefits under our non-qualified deferred compensation plan. Our Level 1 liability is our non-qualified deferred compensation obligation. The Company's Level 1 noncontrolling interests in the Operating Partnership relate to the ownership of Common Units by various individuals and entities other than the Company.

**Level 2.** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the related assets or liabilities.

Our Level 2 assets include the fair value of our mortgages and notes receivable and certain of our interest rate swaps. Our Level 2 liabilities include the fair value of our mortgages and notes payable and the remainder of our interest rate swaps.

The fair value of mortgages and notes receivable and mortgages and notes payable is estimated by the income approach utilizing contractual cash flows and market-based interest rates to approximate the price that would be paid in an orderly transaction between market participants. The fair value of interest rate swaps is determined using the market standard methodology of netting the discounted future fixed cash receipts and the discounted expected variable cash payments. The variable cash payments of interest rate swaps are based on the expectation of future interest rates (forward curves) derived from observed market interest rate curves. In addition, credit valuation adjustments are considered in the fair values to account for potential nonperformance risk, but were concluded to not be significant inputs to the calculation for the periods presented.

**Level 3.** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Our Level 3 asset consisted of our tax increment financing bond, which was not routinely traded but whose fair value was determined by the income approach utilizing contractual cash flows and market-based interest rates to estimate the projected redemption value based on quoted bid/ask prices for similar unrated municipal bonds.

Our Level 3 liability consisted of the fair value of our financing obligation, which was estimated by the income approach to approximate the price that would be paid in an orderly transaction between market participants, utilizing: (1) contractual cash flows; (2) market-based interest rates; and (3) a number of other assumptions including demand for space, competition for customers, changes in market rental rates, costs of operation and expected ownership periods.



**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**11. Disclosure About Fair Value of Financial Instruments – Continued**

The following table sets forth our assets and liabilities and the Company's noncontrolling interests in the Operating Partnership that are measured or disclosed at fair value within the fair value hierarchy.

	Total	Level 1 Quoted Prices in Active Markets for Identical Assets or Liabilities	Level 2 Significant Observable Inputs	Level 3 Significant Unobservable Inputs
<b>Fair Value at December 31, 2016:</b>				
<b>Assets:</b>				
Mortgages and notes receivable, at fair value (1)	\$ 8,833	\$ —	\$ 8,833	\$ —
Interest rate swaps (in prepaid expenses and other assets)	7,619	—	7,619	—
Marketable securities of non-qualified deferred compensation plan (in prepaid expenses and other assets)	2,451	2,451	—	—
<b>Total Assets</b>	<b>\$ 18,903</b>	<b>\$ 2,451</b>	<b>\$ 16,452</b>	<b>\$ —</b>
<b>Noncontrolling Interests in the Operating Partnership</b>	<b>\$ 144,802</b>	<b>\$ 144,802</b>	<b>\$ —</b>	<b>\$ —</b>
<b>Liabilities:</b>				
Mortgages and notes payable, net, at fair value (1)	\$ 1,965,611	\$ —	\$ 1,965,611	\$ —
Interest rate swaps (in accounts payable, accrued expenses and other liabilities)	1,870	—	1,870	—
Non-qualified deferred compensation obligation (in accounts payable, accrued expenses and other liabilities)	2,451	2,451	—	—
<b>Total Liabilities</b>	<b>\$ 1,969,932</b>	<b>\$ 2,451</b>	<b>\$ 1,967,481</b>	<b>\$ —</b>
<b>Fair Value at December 31, 2015:</b>				
<b>Assets:</b>				
Mortgages and notes receivable, at fair value (1)	\$ 2,096	\$ —	\$ 2,096	\$ —
Marketable securities of non-qualified deferred compensation plan (in prepaid expenses and other assets)	2,736	2,736	—	—
Tax increment financing bond (in real estate and other assets, net, held for sale) (2)	11,197	—	—	11,197
<b>Total Assets</b>	<b>\$ 16,029</b>	<b>\$ 2,736</b>	<b>\$ 2,096</b>	<b>\$ 11,197</b>
<b>Noncontrolling Interests in the Operating Partnership</b>	<b>\$ 126,429</b>	<b>\$ 126,429</b>	<b>\$ —</b>	<b>\$ —</b>
<b>Liabilities:</b>				
Mortgages and notes payable, net, at fair value (1)	\$ 2,517,589	\$ —	\$ 2,517,589	\$ —
Interest rate swaps (in accounts payable, accrued expenses and other liabilities)	3,073	—	3,073	—
Non-qualified deferred compensation obligation (in accounts payable, accrued expenses and other liabilities)	2,736	2,736	—	—
Financing obligation, at fair value (in liabilities held for sale) (1) (2)	7,402	—	—	7,402
<b>Total Liabilities</b>	<b>\$ 2,530,800</b>	<b>\$ 2,736</b>	<b>\$ 2,520,662</b>	<b>\$ 7,402</b>

(1) Amounts recorded at historical cost on our Consolidated Balance Sheets at December 31, 2016 and 2015.

(2) Sold during 2016 in conjunction with the sales of the Plaza assets.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**11. Disclosure About Fair Value of Financial Instruments – Continued**

The following table sets forth the changes in our Level 3 asset, which was recorded at fair value on our Consolidated Balance Sheets:

	December 31,	
	2016	2015
<b>Asset:</b>		
<b>Tax Increment Financing Bond:</b>		
Beginning balance	\$ 11,197	\$ 12,447
Principal repayment	—	(1,695)
Assigned to the buyer of the Plaza assets	(11,197)	—
Unrealized gains (in accumulated other comprehensive loss)	—	445
Ending balance	<u>\$ —</u>	<u>\$ 11,197</u>

During 2007, we acquired a tax increment financing bond associated with a parking garage developed by us, which was assigned in conjunction with the sales of the Plaza assets in 2016. The estimated fair value at the date of sale was equal to the outstanding principal amount due on the bond. See Note 8.

The following table sets forth quantitative information about the unobservable input of our Level 3 asset, which was recorded at fair value on our Consolidated Balance Sheets:

	Valuation Technique	Unobservable Input	Rate as of
			December 31, 2015
<b>Asset:</b>			
Tax increment financing bond	Income approach	Discount rate	6.93%

**12. Equity**

**Common Stock Issuances**

During 2016 and 2015, the Company issued 5,078,940 and 2,922,905 shares, respectively, of Common Stock in public offerings and received net proceeds of \$246.2 million and \$124.9 million, respectively. At December 31, 2016, the Company had 98.3 million remaining shares of Common Stock authorized to be issued under its charter.

**Common Stock Dividends**

Dividends of the Company declared per share of Common Stock aggregated \$2.50, \$1.70 and \$1.70 for the years ended December 31, 2016, 2015 and 2014, respectively. Dividends declared in 2016 included a special cash dividend of \$0.80 per share declared in the quarter ended December 31, 2016 and paid January 10, 2017. The principal purpose of the special dividend was to distribute taxable capital gains associated with the sales of the Plaza assets earlier in 2016.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**12. Equity - Continued**

The following table sets forth the Company's estimated taxability to the common stockholders of dividends per share for federal income tax purposes:

	Year Ended December 31,		
	2016 (1)	2015	2014
Ordinary income	\$ 1.15	\$ 1.50	\$ 1.31
Capital gains	1.29	0.13	0.29
Return of capital	—	0.07	0.10
Total	<u>\$ 2.44</u>	<u>\$ 1.70</u>	<u>\$ 1.70</u>

(1) During 2016, cash dividends declared on Common Stock totaled \$2.50 per share, of which approximately \$0.06 will be recognized as a 2017 distribution for federal income tax purposes.

The Company's tax returns have not been examined by the Internal Revenue Service ("IRS") and, therefore, the taxability of dividends is subject to change.

**Preferred Stock**

The following table sets forth the Company's Preferred Stock:

	Issue Date	Number of Shares Outstanding (in thousands)	Carrying Value	Liquidation Preference Per Share	Optional Redemption Date	Annual Dividends Payable Per Share
<b>December 31, 2016</b>						
8.625% Series A Cumulative Redeemable	2/12/1997	29	\$ 28,920	\$ 1,000	2/12/2027	\$ 86.25
<b>December 31, 2015</b>						
8.625% Series A Cumulative Redeemable	2/12/1997	29	\$ 29,050	\$ 1,000	2/12/2027	\$ 86.25

The following table sets forth the Company's estimated taxability to the preferred stockholders of dividends per share for federal income tax purposes:

	Year Ended December 31,		
	2016	2015	2014
<b>8.625% Series A Cumulative Redeemable:</b>			
Ordinary income	\$ 40.65	\$ 79.23	\$ 70.41
Capital gains	45.60	7.02	15.84
Total	<u>\$ 86.25</u>	<u>\$ 86.25</u>	<u>\$ 86.25</u>

The Company's tax returns have not been examined by the IRS and, therefore, the taxability of dividends is subject to change.

**Warrants**

At December 31, 2016 and 2015, we had 15,000 warrants outstanding with an exercise price of \$32.50 per share. Upon exercise of a warrant, the Company will contribute the exercise price to the Operating Partnership in exchange for Common Units. Therefore, the Operating Partnership accounts for such warrants as if issued by the Operating Partnership. These warrants have no expiration date.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**13. Employee Benefit Plans**

**Officer, Management and Director Compensation Programs**

The officers of the Company participate in an annual non-equity incentive program pursuant to which they are eligible to earn cash payments based on a percentage of their annual base salary in effect for December of the applicable year. Under this component of our executive compensation program, officers are eligible to earn additional cash compensation to the extent specific performance-based metrics are achieved during the most recently completed year. The position held by each officer has a target annual incentive percentage that ranges from 35% to 130% of base salary. The more senior the position, the greater the portion of compensation that varies with performance.

The percentage amount an officer may earn under the annual non-equity incentive plan is the product of the target annual incentive percentage times an “actual performance factor,” which can range from zero to 200%. The actual performance factor depends upon the relationship between actual performance in specific areas at each of our divisions and predetermined goals. For corporate officers, the actual performance factor is based on the goals and criteria applied to the Company’s performance as a whole. For officers who oversee our divisions, the actual performance factor is based on the goals and criteria applied partly to that division’s performance and partly to the Company’s performance overall. Amounts under our annual non-equity incentive plan are accrued and expensed in the year earned, but are typically paid early in the succeeding year.

Certain other employees participate in a similar annual non-equity incentive program. Incentive eligibility ranges from 6% to 30% of annual base salary. The actual incentive payment is determined by a mix of the Company’s overall performance, the performance of any applicable division and the individual’s performance during each year. These amounts are also accrued and expensed in the year earned, but are typically paid early in the succeeding year.

The Company’s officers generally receive annual grants of stock options and restricted stock under the Company’s long-term equity incentive plan on or about March 1 of each year. Restricted stock grants are also made annually to directors and certain other employees. Dividends received on restricted stock are non-forfeitable and are paid at the same rate and on the same date as on shares of Common Stock, except that, with respect to shares of total return-based restricted stock issued to the Company’s chief executive officer, dividends accumulate and are payable only if and to the extent the shares vest. Dividends paid on subsequently forfeited shares are expensed. Additional shares of total return-based restricted stock may be issued at the end of the applicable measurement periods if and to the extent actual performance exceeds certain levels of performance. Such additional shares, if any, would be fully vested when issued. No expense is recorded for additional shares of total return-based restricted stock that may be issued at the end of the applicable measurement period since that possibility is reflected in the grant date fair value. The following table sets forth the number of shares of Common Stock reserved for future issuance under the Company’s long-term equity incentive plans:

	December 31,	
	2016	2015
Outstanding stock options and warrants	602,115	702,228
Possible future issuance under equity incentive plans	2,718,296	3,084,158
	<u>3,320,411</u>	<u>3,786,386</u>

Of the possible future issuance under the Company’ long-term equity incentive plans at December 31, 2016, no more than an additional 1.0 million shares can be in the form of restricted stock.

During the years ended December 31, 2016, 2015 and 2014, we recognized \$6.3 million, \$6.9 million and \$6.9 million, respectively, of share-based compensation expense. Because REITs generally do not pay income taxes, we do not realize tax benefits on share-based payments. At December 31, 2016, there was \$5.1 million of total unrecognized share-based compensation costs, which will be recognized over a weighted average remaining contractual term of 2.2 years.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**13. Employee Benefit Plans - Continued**

**- Stock Options**

Stock options issued after 2013 vest ratably on an annual basis over four years and expire after 10 years. Stock options issued from 2010 through 2013 vest ratably on an annual basis over four years and expire after seven years. The value of all options as of the date of grant is calculated using the Black-Scholes option-pricing model and is amortized over the respective vesting period or the service period, if shorter, for employees who are or will become eligible under the Company's retirement plan. The weighted average fair values of options granted during 2016, 2015 and 2014 were \$4.61, \$6.19 and \$6.75, respectively, per option. The fair values of the options granted were determined at the grant dates using the following assumptions:

	2016	2015	2014
Risk free interest rate (1)	1.4%	1.7%	1.8%
Common stock dividend yield (2)	3.9%	3.7%	4.5%
Expected volatility (3)	19.7%	22.4%	30.3%
Average expected option life (years) (4)	5.75	5.75	5.75

- (1) Represents the interest rate as of the grant date on US treasury bonds having the same life as the estimated life of the option grants.
- (2) The dividend yield is calculated utilizing the dividends paid for the previous one-year period and the per share price of Common Stock on the date of grant.
- (3) Based on the historical volatility of Common Stock over a period relevant to the related stock option grant.
- (4) The average expected option life is based on an analysis of the Company's historical data.

The following table sets forth stock option activity:

	Options Outstanding	
	Number of Options	Weighted Average Exercise Price
Balance at December 31, 2013	874,382	\$ 32.24
Options granted	190,330	37.90
Options canceled	(134,628)	41.93
Options exercised	(352,763)	27.21
Balance at December 31, 2014	577,321	34.92
Options granted	197,408	45.61
Options canceled	(3,829)	40.21
Options exercised	(83,672)	34.89
Balance at December 31, 2015	687,228	37.97
Options granted	244,664	43.55
Options canceled	(14,743)	42.64
Options exercised	(330,034)	34.26
Balance at December 31, 2016 (1) (2)	587,115	\$ 42.26

- (1) The outstanding options at December 31, 2016 had a weighted average remaining life of 7.9 years.
- (2) The Company had 74,080 options exercisable at December 31, 2016 with a weighted average exercise price of \$40.28, weighted average remaining life of 6.6 years and intrinsic value of \$0.8 million. Of these exercisable options, there were no exercise prices higher than the market price of our Common Stock at December 31, 2016.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**13. Employee Benefit Plans - Continued**

Cash received or receivable from options exercised was \$13.4 million, \$3.3 million and \$11.1 million for the years ended December 31, 2016, 2015 and 2014, respectively. The total intrinsic value of options exercised during the years ended December 31, 2016, 2015 and 2014 was \$4.8 million, \$0.9 million and \$5.0 million, respectively. The total intrinsic value of options outstanding at December 31, 2016, 2015 and 2014 was \$5.1 million, \$4.3 million and \$5.4 million, respectively. The Company generally does not permit the net cash settlement of exercised stock options, but does permit net share settlement so long as the shares received are held for at least a year. The Company has a practice of issuing new shares to satisfy stock option exercises.

**- Time-Based Restricted Stock**

Shares of time-based restricted stock vest ratably on an annual basis over four years. The value of grants of time-based restricted stock is based on the market value of Common Stock as of the date of grant and is amortized to expense over the respective vesting period or the service period, if shorter, for employees who are or will become eligible under the Company's retirement plan.

The following table sets forth time-based restricted stock activity:

	Number of Shares	Weighted Average Grant Date Fair Value
Restricted shares outstanding at December 31, 2013	212,796	\$ 33.96
Awarded and issued (1)	94,932	37.76
Vested (2)	(85,660)	32.87
Restricted shares outstanding at December 31, 2014	222,068	35.97
Awarded and issued (1)	71,994	45.91
Vested (2)	(85,809)	35.14
Forfeited	(3,533)	39.94
Restricted shares outstanding at December 31, 2015	204,720	39.74
Awarded and issued (1)	72,698	43.59
Vested (2)	(84,212)	37.76
Forfeited	(4,225)	41.96
Restricted shares outstanding at December 31, 2016	188,981	\$ 42.06

- (1) The weighted average fair value at grant date of time-based restricted stock issued during the years ended December 31, 2016, 2015 and 2014 was \$3.2 million, \$3.3 million and \$3.6 million, respectively.
- (2) The vesting date fair value of time-based restricted stock that vested during the years ended December 31, 2016, 2015 and 2014 was \$3.7 million, \$3.9 million and \$3.2 million, respectively. Vested shares include those shares surrendered by employees to satisfy tax withholding obligations in connection with such vesting.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**13. Employee Benefit Plans - Continued**

**- Total Return-Based Restricted Stock**

Shares of total return-based restricted stock vest to the extent the Company's absolute total returns for certain pre-determined three-year periods exceed predetermined goals. The amount subject to vesting ranges from zero to 150%. Notwithstanding the Company's absolute total return, if the Company's total return exceeds 100% of the peer group total return index, at least 75% of total return-based restricted stock issued will vest at the end of the applicable period. The weighted average grant date fair value of such shares of total return-based restricted stock issued in 2016, 2015 and 2014 was determined to be \$41.37, \$43.77 and \$35.58, respectively, and is amortized over the respective three-year period or the service period, if shorter, for employees who are or will become eligible under the Company's retirement plan. The fair values of the total return-based restricted stock granted were determined at the grant dates using a Monte Carlo simulation model and the following assumptions:

	2016	2015	2014
Risk free interest rate (1)	0.9%	1.0%	0.7%
Common stock dividend yield (2)	4.1%	3.8%	4.7%
Expected volatility (3)	43.1%	43.0%	43.4%

- (1) Represents the interest rate as of the grant date on US treasury bonds having the same life as the estimated life of the total return-based restricted stock grants.
- (2) The dividend yield is calculated utilizing the dividends paid for the previous one-year period and the average per share price of Common Stock during the three-month period preceding the date of grant.
- (3) Based on the historical volatility of Common Stock over a period relevant to the related total return-based restricted stock grant.

The following table sets forth total return-based restricted stock activity:

	Number of Shares	Weighted Average Grant Date Fair Value
Restricted shares outstanding at December 31, 2013	133,388	\$ 35.29
Awarded and issued (1)	74,569	35.58
Restricted shares outstanding at December 31, 2014	207,957	35.70
Awarded and issued (1) (3)	118,817	37.64
Vested (2) (3)	(129,762)	31.97
Forfeited	(1,709)	37.25
Restricted shares outstanding at December 31, 2015	195,303	36.66
Awarded and issued (1) (3)	64,701	40.87
Vested (2) (3)	(71,617)	36.50
Forfeited	(4,663)	39.91
Restricted shares outstanding at December 31, 2016	183,724	\$ 39.82

- (1) The fair value at grant date of total return-based restricted stock issued during the years ended December 31, 2016, 2015 and 2014 was \$2.4 million, \$2.5 million and \$2.7 million, respectively, at target.
- (2) The vesting date fair value of total return-based restricted stock that vested during the years ended December 31, 2016 and 2015 was \$3.1 million and \$5.9 million, respectively, based on the performance of the specific plans. Vested shares include those shares surrendered by employees to satisfy tax withholding obligations in connection with such vesting. There were no vested shares of total return-based restricted stock during the year ended December 31, 2014.
- (3) The 2016 and 2015 amounts include 6,647 and 61,860 additional shares, respectively, from the 2013 and 2012 plans, respectively, since the plans' payouts were in excess of the initial 100% target.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**13. Employee Benefit Plans - Continued**

**401(k) Retirement Savings Plan**

We have a 401(k) Retirement Savings Plan covering substantially all employees who meet certain age and employment criteria. We contribute amounts for each participant at a rate of 75% of the employee's contribution (up to 6% of each employee's bi-weekly salary and cash incentives, subject to statutory limits). During the years ended December 31, 2016, 2015 and 2014, we contributed \$1.3 million, \$1.3 million and \$1.2 million, respectively, to the 401(k) savings plan. The assets of this qualified plan are not included in our Consolidated Financial Statements since the assets are not owned by us.

**Retirement Plan**

The Company has a retirement plan for employees with at least 30 years of continuous service or are at least 55 years old with at least 10 years of continuous service. Subject to advance written notice and a non-compete agreement, eligible retirees would be entitled to receive a pro rata amount of the annual non-equity incentive compensation earned during the year of retirement and stock options and time-based restricted stock would be non-forfeitable and vest according to the terms of their original grants. Eligible retirees would also be entitled to retain any total return-based restricted stock that subsequently vests after the retirement date according to the terms of their original grants. For employees who meet the age and service eligibility requirements, 100% of their annual grants are expensed at the grant date as if fully vested. For employees who will meet the age and service eligibility requirements within the normal vesting periods, the grants are amortized over the shorter service period.

**Deferred Compensation**

Prior to 2010, officers could elect to defer all or a portion of their cash compensation, which was then invested in unrelated mutual funds under our non-qualified deferred compensation plan. These investments are recorded at fair value, which aggregated \$2.5 million and \$2.7 million at December 31, 2016 and 2015, respectively, and are included in prepaid expenses and other assets, with an offsetting deferred compensation liability recorded in accounts payable, accrued expenses and other liabilities. Deferred amounts ultimately payable to the participants are based on the value of the related mutual fund investments. Accordingly, changes in the value of the unrelated mutual funds are recorded in interest and other income and the corresponding offsetting changes in the deferred compensation liability are recorded in general and administration expense. As a result, there is no effect on our net income.

The following table sets forth our deferred compensation liability:

	Year Ended December 31,		
	2016	2015	2014
Beginning deferred compensation liability	\$ 2,736	\$ 3,635	\$ 3,996
Mark-to-market adjustment to deferred compensation (in general and administrative expenses)	222	(32)	235
Distributions from deferred compensation plans	(507)	(867)	(596)
Total deferred compensation liability	<u>\$ 2,451</u>	<u>\$ 2,736</u>	<u>\$ 3,635</u>

**Employee Stock Purchase Plan**

The Company has an Employee Stock Purchase Plan ("ESPP") pursuant to which employees may contribute up to 25% of their cash compensation for the purchase of Common Stock. At the end of each quarterly offering period, each participant's account balance, which includes any and all accumulated dividends, is applied to acquire shares of Common Stock at a cost that is calculated at 85% of the average closing price on the New York Stock Exchange on the five consecutive days preceding the last day of the quarter. In the years ended December 31, 2016, 2015 and 2014, the Company issued 27,773, 29,496 and 28,682 shares, respectively, of Common Stock under this Plan. The 15% discount on newly issued shares, which is taxable income to the participants and is recorded by us as additional compensation expense, aggregated \$0.2 million in each of the years ended December 31, 2016, 2015 and 2014. As a general rule, shares purchased under the Plan must be held for at least a year. The Company satisfies its ESPP obligations by issuing additional shares of Common Stock.



**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**14. Accumulated Other Comprehensive Income/(Loss)**

The following table sets forth the components of accumulated other comprehensive income/(loss):

	December 31,	
	2016	2015
<b>Tax increment financing bond:</b>		
Beginning balance	\$ —	\$ (445)
Unrealized gains on tax increment financing bond	—	445
Ending balance	—	—
<b>Cash flow hedges:</b>		
Beginning balance	(3,811)	(3,467)
Unrealized gains/(losses) on cash flow hedges	5,703	(4,040)
Amortization of cash flow hedges (1)	3,057	3,696
Ending balance	4,949	(3,811)
<b>Total accumulated other comprehensive income/(loss)</b>	<b>\$ 4,949</b>	<b>\$ (3,811)</b>

(1) Amounts reclassified out of accumulated other comprehensive income/(loss) into contractual interest expense.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**15. Rental and Other Revenues; Rental Property and Other Expenses**

Our real estate assets are leased to customers under operating leases. The minimum rental amounts under the leases are generally subject to scheduled fixed increases. Generally, the leases also provide that we receive cost recovery income from customers for increases in certain costs above the costs incurred during a contractually specified base year. The following table sets forth our rental and other revenues from continuing operations:

	Year Ended December 31,		
	2016	2015	2014
Contractual rents, net	\$ 561,242	\$ 513,909	\$ 476,684
Straight-line rental income, net	23,909	22,054	21,045
Cost recovery income, net	48,730	45,247	39,112
Lease termination fees	2,311	990	658
Other miscellaneous operating revenues	29,442	22,471	18,372
	<u>\$ 665,634</u>	<u>\$ 604,671</u>	<u>\$ 555,871</u>

The following table sets forth our scheduled future minimum base rents to be received from customers for leases in effect at December 31, 2016 for the properties that we wholly own:

2017	\$ 590,003
2018	566,742
2019	505,687
2020	427,392
2021	367,053
Thereafter	1,247,247
	<u>\$ 3,704,124</u>

The following table sets forth our rental property and other expenses from continuing operations:

	Year Ended December 31,		
	2016	2015	2014
Utilities, insurance and real estate taxes	\$ 124,940	\$ 117,470	\$ 113,226
Maintenance, cleaning and general building	86,221	79,091	74,109
Property management and administrative expenses	12,588	12,446	12,093
Other miscellaneous operating expenses	7,336	6,934	6,456
	<u>\$ 231,085</u>	<u>\$ 215,941</u>	<u>\$ 205,884</u>

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(tabular dollar amounts in thousands, except per share data)

**16. Real Estate, Other Assets and Liabilities Held For Sale and Discontinued Operations**

The following tables set forth the assets and liabilities related to discontinued operations at December 31, 2016 and 2015 and the results of operations and cash flows for the years ended December 31, 2016, 2015 and 2014:

	December 31,	
	2016	2015
<b>Assets:</b>		
Land	\$ —	\$ 16,681
Buildings and tenant improvements	—	322,811
Land held for development	—	1,089
Less-accumulated depreciation	—	(131,274)
Net real estate assets	—	209,307
Accrued straight-line rents receivable, net	—	11,730
Deferred leasing costs, net	—	6,690
Prepaid expenses and other assets, net	—	13,221
<b>Real estate and other assets, net, held for sale</b>	<b>\$ —</b>	<b>\$ 240,948</b>
<b>Liabilities:</b>		
Accounts payable, accrued expenses and other liabilities	\$ —	\$ (6,717)
Financing obligation	—	(7,402)
<b>Liabilities held for sale</b>	<b>\$ —</b>	<b>\$ (14,119)</b>

	Year Ended December 31,		
	2016	2015	2014
<b>Rental and other revenues</b>	<b>\$ 8,484</b>	<b>\$ 50,935</b>	<b>\$ 52,597</b>
<b>Operating expenses:</b>			
Rental property and other expenses	3,334	20,805	19,620
Depreciation and amortization	—	14,039	15,386
General and administrative	1,388	2,366	965
Total operating expenses	4,722	37,210	35,971
<b>Interest expense</b>	<b>85</b>	<b>621</b>	<b>725</b>
<b>Other income</b>	<b>420</b>	<b>2,635</b>	<b>2,700</b>
<b>Income from discontinued operations</b>	<b>4,097</b>	<b>15,739</b>	<b>18,601</b>
Net gains on disposition of discontinued operations	414,496	—	384
<b>Total income from discontinued operations</b>	<b>\$ 418,593</b>	<b>\$ 15,739</b>	<b>\$ 18,985</b>

	Year Ended December 31,		
	2016	2015	2014
Cash flows from operating activities	\$ 2,040	\$ 27,579	\$ 32,485
Cash flows from investing activities	\$ 417,097	\$ (16,445)	\$ (8,279)

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**17. Earnings Per Share**

The following table sets forth the computation of basic and diluted earnings per share of the Company:

	Year Ended December 31,		
	2016	2015	2014
<b>Earnings per Common Share - basic:</b>			
<b>Numerator:</b>			
Income from continuing operations	\$ 122,546	\$ 85,521	\$ 96,987
Net (income) attributable to noncontrolling interests in the Operating Partnership from continuing operations	(3,331)	(2,443)	(2,945)
Net (income) attributable to noncontrolling interests in consolidated affiliates from continuing operations	(1,253)	(1,264)	(1,466)
Dividends on Preferred Stock	(2,501)	(2,506)	(2,507)
Income from continuing operations available for common stockholders	115,461	79,308	90,069
Income from discontinued operations	418,593	15,739	18,985
Net (income) attributable to noncontrolling interests in the Operating Partnership from discontinued operations	(12,265)	(475)	(597)
Income from discontinued operations available for common stockholders	406,328	15,264	18,388
Net income available for common stockholders	<u>\$ 521,789</u>	<u>\$ 94,572</u>	<u>\$ 108,457</u>
<b>Denominator:</b>			
Denominator for basic earnings per Common Share – weighted average shares	98,439	94,404	90,743
Earnings per Common Share - basic:			
Income from continuing operations available for common stockholders	\$ 1.17	\$ 0.84	\$ 1.00
Income from discontinued operations available for common stockholders	4.13	0.16	0.20
Net income available for common stockholders	<u>\$ 5.30</u>	<u>\$ 1.00</u>	<u>\$ 1.20</u>
<b>Earnings per Common Share - diluted:</b>			
<b>Numerator:</b>			
Income from continuing operations	\$ 122,546	\$ 85,521	\$ 96,987
Net (income) attributable to noncontrolling interests in consolidated affiliates from continuing operations	(1,253)	(1,264)	(1,466)
Dividends on Preferred Stock	(2,501)	(2,506)	(2,507)
Income from continuing operations available for common stockholders before net (income) attributable to noncontrolling interests in the Operating Partnership	118,792	81,751	93,014
Income from discontinued operations available for common stockholders	418,593	15,739	18,985
Net income available for common stockholders before net (income) attributable to noncontrolling interests in the Operating Partnership	<u>\$ 537,385</u>	<u>\$ 97,490</u>	<u>\$ 111,999</u>
<b>Denominator:</b>			
Denominator for basic earnings per Common Share – weighted average shares	98,439	94,404	90,743
Add:			
Stock options using the treasury method	87	87	119
Noncontrolling interests Common Units	2,872	2,915	2,938
Denominator for diluted earnings per Common Share – adjusted weighted average shares and assumed conversions (1)	<u>101,398</u>	<u>97,406</u>	<u>93,800</u>
Earnings per Common Share - diluted:			
Income from continuing operations available for common stockholders	\$ 1.17	\$ 0.84	\$ 0.99
Income from discontinued operations available for common stockholders	4.13	0.16	0.20
Net income available for common stockholders	<u>\$ 5.30</u>	<u>\$ 1.00</u>	<u>\$ 1.19</u>

(1) Includes all unvested restricted stock where dividends on such restricted stock are non-forfeitable.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**18. Income Taxes**

Our Consolidated Financial Statements include the operations of the Company's taxable REIT subsidiary, which is not entitled to the dividends paid deduction and is subject to federal, state and local income taxes on its taxable income. As a REIT, the Company may also be subject to federal excise taxes if it engages in certain types of transactions.

The minimum dividend per share of Common Stock required for the Company to maintain its REIT status was \$0.99, \$1.31 and \$1.13 per share in 2016, 2015 and 2014, respectively. Continued qualification as a REIT depends on the Company's ability to satisfy the dividend distribution tests, stock ownership requirements and various other qualification tests. The tax basis of the Company's assets (net of accumulated tax depreciation and amortization) and liabilities was approximately \$4.0 billion and \$2.3 billion, respectively, at December 31, 2016 and \$4.2 billion and \$2.6 billion, respectively, at December 31, 2015.

During the years ended December 31, 2016, 2015 and 2014, the Company qualified as a REIT and incurred no federal income tax expense; accordingly, the only federal income taxes included in the accompanying Consolidated Financial Statements relate to activities of the Company's taxable REIT subsidiary.

The following table sets forth the Company's income tax expense/(benefit):

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Current tax expense/(benefit):</b>			
Federal	\$ (38)	\$ 949	\$ 1,480
State	89	351	161
	51	1,300	1,641
<b>Deferred tax expense/(benefit):</b>			
Federal	(160)	(233)	(1,628)
State	87	(115)	(305)
	(73)	(348)	(1,933)
Less tax expense netted against gain on disposition of property	—	(518)	—
<b>Total income tax expense/(benefit)</b>	<b>\$ (22)</b>	<b>\$ 434</b>	<b>\$ (292)</b>

The Company's net deferred tax liability was \$0.1 million and \$0.2 million as of December 31, 2016 and 2015, respectively. The net deferred tax liability is comprised primarily of tax versus book differences related to property (depreciation, amortization and basis differences).

For the years ended December 31, 2016 and 2015, there were no unrecognized tax benefits. The Company is subject to federal, state and local income tax examinations by taxing authorities for 2013 through 2016. The Company does not expect that the total amount of unrecognized benefits will materially change within the next year.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**19. Segment Information**

Our principal business is the operation, acquisition and development of rental real estate properties. We evaluate our business by product type and by geographic location. Each product type has different customers and economic characteristics as to rental rates and terms, cost per rentable square foot of buildings, the purposes for which customers use the space, the degree of maintenance and customer support required and customer dependency on different economic drivers, among others. The operating results by geographic grouping are also regularly reviewed by our chief operating decision maker for assessing performance and other purposes. There are no material inter-segment transactions.

Our accounting policies of the segments are the same as those used in our Consolidated Financial Statements. All operations are within the United States.

The following tables summarize the rental and other revenues and net operating income, the primary industry property-level performance metric used by our chief operating decision maker which is defined as rental and other revenues less rental property and other expenses, for each of our reportable segments. Our segment information for the year ended December 31, 2014 has been retrospectively revised from previously reported amounts to reflect a change in our reportable segments.

	Year Ended December 31,		
	2016	2015	2014
<b>Rental and Other Revenues:</b>			
Office:			
Atlanta	\$ 134,601	\$ 108,590	\$ 96,075
Greensboro	20,522	21,251	25,018
Memphis	48,251	47,137	41,016
Nashville	95,912	88,310	80,722
Orlando	46,260	44,621	36,574
Pittsburgh	58,789	59,392	56,692
Raleigh	112,958	102,841	87,428
Richmond	44,315	42,089	45,559
Tampa	89,903	75,715	69,693
Total Office Segment	651,511	589,946	538,777
Other	14,123	14,725	17,094
Total Rental and Other Revenues	\$ 665,634	\$ 604,671	\$ 555,871

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(tabular dollar amounts in thousands, except per share data)

**19. Segment Information - Continued**

	Year Ended December 31,		
	2016	2015	2014
<b>Net Operating Income:</b>			
Office:			
Atlanta	\$ 84,733	\$ 67,094	\$ 58,180
Greensboro	12,781	13,395	15,784
Memphis	30,038	29,534	24,376
Nashville	68,678	62,387	55,354
Orlando	26,525	25,524	21,286
Pittsburgh	34,175	34,348	31,505
Raleigh	80,803	72,981	61,317
Richmond	30,505	27,922	30,021
Tampa	56,493	45,447	40,875
Total Office Segment	424,731	378,632	338,698
Other	9,818	10,098	11,289
Total Net Operating Income	434,549	388,730	349,987
<b>Reconciliation to income from continuing operations before disposition of investment properties and activity in unconsolidated affiliates:</b>			
Depreciation and amortization	(220,140)	(201,918)	(180,637)
Impairments of real estate assets	—	—	(588)
General and administrative expenses	(38,153)	(37,642)	(35,258)
Interest expense	(76,648)	(86,052)	(85,127)
Other income	2,338	1,726	2,431
<b>Income from continuing operations before disposition of investment properties and activity in unconsolidated affiliates</b>	<b>\$ 101,946</b>	<b>\$ 64,844</b>	<b>\$ 50,808</b>

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**19. Segment Information - Continued**

	December 31,	
	2016	2015
<b>Total Assets:</b>		
Office:		
Atlanta	\$ 1,039,519	\$ 1,013,226
Greensboro	127,887	131,027
Memphis	271,115	277,866
Nashville	714,905	591,111
Orlando	307,021	303,843
Pittsburgh	353,816	339,186
Raleigh	760,607	663,617
Richmond	212,508	211,574
Tampa	553,068	548,814
Total Office Segment	4,340,446	4,080,264
Other (1)	220,604	405,367
Total Assets	<u>\$ 4,561,050</u>	<u>\$ 4,485,631</u>

(1) Includes the Plaza assets, which were included in real estate and other assets, net, held for sale on our Consolidated Balance Sheets at December 31, 2015.



**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**20. Quarterly Financial Data (Unaudited)**

The following tables set forth quarterly financial information of the Company:

	Year Ended December 31, 2016				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Rental and other revenues	\$ 164,859	\$ 166,860	\$ 166,269	\$ 167,646	\$ 665,634
Income from continuing operations	28,142	33,528	33,840	27,036	122,546
Income from discontinued operations (1)	418,593	—	—	—	418,593
Net income	446,735	33,528	33,840	27,036	541,139
Net (income) attributable to noncontrolling interests in the Operating Partnership	(13,011)	(939)	(926)	(720)	(15,596)
Net (income) attributable to noncontrolling interests in consolidated affiliates	(308)	(314)	(319)	(312)	(1,253)
Dividends on Preferred Stock	(626)	(627)	(624)	(624)	(2,501)
Net income available for common stockholders	<u>\$ 432,790</u>	<u>\$ 31,648</u>	<u>\$ 31,971</u>	<u>\$ 25,380</u>	<u>\$ 521,789</u>
<b>Earnings per Common Share – basic:</b>					
Income from continuing operations available for common stockholders	\$ 0.27	\$ 0.32	\$ 0.32	\$ 0.25	\$ 1.17
Income from discontinued operations available for common stockholders	4.22	—	—	—	4.13
Net income available for common stockholders	<u>\$ 4.49</u>	<u>\$ 0.32</u>	<u>\$ 0.32</u>	<u>\$ 0.25</u>	<u>\$ 5.30</u>
<b>Earnings per Common Share – diluted:</b>					
Income from continuing operations available for common stockholders	\$ 0.27	\$ 0.32	\$ 0.32	\$ 0.25	\$ 1.17
Income from discontinued operations available for common stockholders	4.22	—	—	—	4.13
Net income available for common stockholders	<u>\$ 4.49</u>	<u>\$ 0.32</u>	<u>\$ 0.32</u>	<u>\$ 0.25</u>	<u>\$ 5.30</u>

(1) See Note 2 for a discussion regarding the sales of the Plaza assets.

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
(tabular dollar amounts in thousands, except per share data)

**20. Quarterly Financial Data (Unaudited) - Continued**

	Year Ended December 31, 2015				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Rental and other revenues	\$ 145,236	\$ 148,543	\$ 150,766	\$ 160,126	\$ 604,671
Income from continuing operations	16,920	22,221	27,352	19,028	85,521
Income from discontinued operations	3,915	4,670	4,265	2,889	15,739
Net income	20,835	26,891	31,617	21,917	101,260
Net (income) attributable to noncontrolling interests in the Operating Partnership	(596)	(782)	(918)	(622)	(2,918)
Net (income) attributable to noncontrolling interests in consolidated affiliates	(296)	(328)	(324)	(316)	(1,264)
Dividends on Preferred Stock	(627)	(626)	(626)	(627)	(2,506)
Net income available for common stockholders	<u>\$ 19,316</u>	<u>\$ 25,155</u>	<u>\$ 29,749</u>	<u>\$ 20,352</u>	<u>\$ 94,572</u>
<b>Earnings per Common Share – basic:</b>					
Income from continuing operations available for common stockholders	\$ 0.17	\$ 0.22	\$ 0.27	\$ 0.18	\$ 0.84
Income from discontinued operations available for common stockholders	0.04	0.05	0.04	0.03	0.16
Net income available for common stockholders	<u>\$ 0.21</u>	<u>\$ 0.27</u>	<u>\$ 0.31</u>	<u>\$ 0.21</u>	<u>\$ 1.00</u>
<b>Earnings per Common Share – diluted:</b>					
Income from continuing operations available for common stockholders	\$ 0.17	\$ 0.22	\$ 0.27	\$ 0.18	\$ 0.84
Income from discontinued operations available for common stockholders	0.04	0.05	0.04	0.03	0.16
Net income available for common stockholders	<u>\$ 0.21</u>	<u>\$ 0.27</u>	<u>\$ 0.31</u>	<u>\$ 0.21</u>	<u>\$ 1.00</u>

**HIGHWOODS PROPERTIES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(tabular dollar amounts in thousands, except per share data)**

**21. Subsequent Events**

On January 10, 2017, the Company paid a special cash dividend of \$0.80 per share to stockholders of record as of December 27, 2016. The principal purpose of the special dividend was to distribute taxable capital gains associated with the sales of the Plaza assets earlier in 2016.

On February 7, 2017, the Company declared a regular cash dividend of \$0.44 per share of Common Stock, which is payable on March 7, 2017 to stockholders of record as of February 17, 2017.

